TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1960

No. 357

UNITED STATES, PETITIONER

vs.

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED AUGUST 23, 1960
CERTIORARI GRANTED NOVEMBER 14, 1960

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INDEX

	Original	Print
Proceedings in the U. S. C. A. for the Second Circuit		
Joint appendix consisting of the record from the U. S. D. C. for the Southern District of New York	A	1
Summary statement of proceedings in Court below	1	1
Proceedings from which appeal is taken	4	3
Decision, Order and Judgment	4	3
Stipulation on Facts and Legal Issue	5	4

	Original	Print
Pleadings	60	13
Complaint	60	13
Exhibit A—Claim to be filed with the District Director where assessment was made or tax paid	63	15
Schedule "A"	77	26
Schedule "B"	78	27
Schedule "C"	79	28
Schedule "D"	80	29
Schedule "E"	81	30
Schedule "F"	82	31
Exhibit B—Duplicate claim to be filed with the Collector where assessment was made or tax paid	83	32
Schedule "A"	84	33
Answer	89	36
Amendment to answer	91	38
Opinion, Swan, J.	95	39
Dissenting opinion, Clark, J.	104	47
Judgment	109	51
Clerk's certificate (omitted in printing)	111	51
Order allowing certiorari	112	52

[fol. A]

IN THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.,
PLAINTIFF-APPELLANT

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLEE

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

JOINT APPENDIX

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* * * *

[fol. 1] IN UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

I.

SUMMARY STATEMENT OF PROCEEDINGS IN COURT BELOW

This appeal is taken from the denial of plaintiff's motion for summary judgment, the granting of defendant's cross-motion for summary judgment dismissing the complaint, and the judgment entered thereon.

The complaint, seeking refund of an overpayment of $5,769,159.92 income taxes for 1951, was filed on June 6, 1956.

The answer, interposing a general denial and affirmative defense of collateral estoppel was filed November 30, 1956.

The defendant's motion for summary judgment on its affirmative defense of collateral estoppel was denied on June 5, 1958.

On June 23, 1959, the parties, through their respective attorneys, entered into a stipulation eliminating all factual issues and narrowing the legal issue to be presented for determination.

On June 23, 1959, the plaintiff moved for summary judgment, based upon the pleadings and stipulation. On August 17, 1959, based upon the same papers, the defendant made a cross-motion for summary judgment dismissing the complaint.

On October 23, 1959, the decision of Judge Sugarman, denying plaintiff's motion and granting defendant's motion, was filed and the judgment thereon was entered.

On December 2, 1959, the plaintiff filed its notice of the appeal above mentioned.

[fols. 2-3] • • •

[fol. 4] IN UNITED STATES
DISTRICT COURT

III.

PROCEEDINGS FROM WHICH APPEAL IS TAKEN

DECISION, ORDER AND JUDGMENT—October 23, 1959

The facts presented by this litigation are set forth in Judge Palmieri's decision in *Consolidated Edison Company of New York* v. *United States*, 162 F. Supp. 854 (S. D. N. Y. 1958).

The identical issues presented by this litigation, except that they dealt with earlier years, are set forth in Judge Littleton's decision in *Consolidated Edison Company of New York* v. *United States*, 135 F. Supp. 881 (Ct. Cl. 1955), *cert. denied* 351 U. S. 909. No gainful purpose can be served by repeating the facts or issues.

Assuming that *Standard Oil Company* v. *United States* 51 AFTR 1688, 56-2 U. S. T. C. Para. 10051 (N. D. Ohio 1956), is not distinguishable on its facts from *Consolidated Edison Company of New York* v. *United States*, *supra*, I am disposed to follow what was said in the latter case. Accordingly, the plaintiff's motion for summary judgment is denied and the defendant's motion for summary judgment, dismissing the complaint, is granted.

It is so ordered. No further order is necessary.

SIDNEY SUGARMAN
United States District Judge

Judgment entered October 23, 1959.

HERBERT A. CHARLSON, Clerk

[fol. 5] IN UNITED STATES
DISTRICT COURT

STIPULATION ON FACTS AND LEGAL ISSUE—June 23, 1959

IT IS HEREBY STIPULATED AND AGREED by and between the undersigned attorneys for the respective parties:

1. The pleadings are hereby amended to eliminate the issues raised herein with respect to

(a) New York City real estate taxes for the City's fiscal year ending June 30, 1946, and all fiscal years prior thereto, and

(b) depreciation.

2. The pleadings are hereby amended to eliminate all issues of fact other than the determination of the amounts involved herein, which determination is to be made as hereinafter more specifically provided.

3. The pleadings are hereby amended to raise the sole issue of law, namely:

> whether, under Section 23(c) of the Internal Revenue Code of 1939, a contested real estate tax liability accrues in the year the litigation is settled or, prior thereto, in the year the disputed tax is involuntarily paid.

Dependent upon this issue is a collateral issue,

> whether the right to a partial refund of the contested and involuntarily paid tax, as determined by the settlement, constitutes accrued income in the year of settlement.

[fol. 6] These issues of law are identical with the legal issues presented to, and decided by, the United States Court of Claims in *Consolidated Edison Company of New York, Inc.* v. *United States* (1955), 133 Ct. Cls. 376; 135 F. Supp. 881 (hereinafter referred to as the "prior suit").

On these issues of law plaintiff maintains that

(a) $8,614,720.22 was erroneously disallowed as a deduction in 1951, and

(b) $2,487,935 was erroneously included in its gross income for 1951.

The method by which these figures are arrived at is set forth in paragraphs 7 and 8, infra.

Nothing contained herein, however, shall be construed as a limitation or qualification of the Government's right to raise the question of *res judicata* or collateral estoppel on any appeal taken herein.

4. During the calendar years 1946 to 1950, inclusive, the plaintiff owned hundreds of parcels of real estate in the City of New York which were subject to New York City real estate of corporations tax (hereinafter referred to as real estate tax).

5. The City of New York operated on a fiscal year basis, commencing July 1 and ending the following June 30.

6. For each of the New York City fiscal years 1946/1947 to 1950/1951, inclusive, and pursuant to the laws of the State of New York and the City of New York

(a) the New York City Tax Commission fixed, for real estate tax purposes, on each and every parcel of [fol. 7] real estate owned by plaintiff, a tentative assessed valuation thereon as of the taxable status date, January 25, preceding the fiscal year involved;

(b) plaintiff filed bona fide protests with said Tax Commission on or before the following March 15, claiming overvaluations with respect to some of said parcels and stating the amounts that were claimed to be the correct valuations thereon as of the taxable status date;

(c) the Tax Commission, on or before the following May 25, fixed final assessed valuations on said contested parcels, which final assessed valuations were placed upon the final assessment rolls;

(d) the New York City Council, on or before the following June 25, established the real estate tax rates for the ensuing fiscal year;

(e) real estate tax bills, the product of the final assessed valuations and the established tax rates for

the fiscal years involved, were sent to plaintiff for the real estate parcels owned by plaintiff, which bills were payable in two equal installments, on October 1 and April 1 of said fiscal year. The amounts of taxes thus billed bore penalty interest at the rate of 7% per annum if not paid within one month of the due dates and became liens on the properties involved as of said due dates, which liens could not be suspended (148) or removed, except by payment of the amounts billed, and which liens, in the event of non payment of the amounts billed, could be foreclosed like a judgment lien, regardless of the fact that the tax was being contested;

[fol. 8] (f) the plaintiff, on or before October 25, duly instituted in the Supreme Court of the State of New York bona fide legal proceedings, commonly referred to as certiorari proceedings, contesting the correctness of the final assessed valuations placed upon some of its real estate parcels and seeking a judicial review thereof; these certiorari proceedings were the exclusive statutory method by which plaintiff could obtain a judicial review of the protested and contested assessed valuations; in the petitions filed therein, plaintiff stated the amounts it claimed to be the correct valuations, as of the taxable status dates, of the properties involved; such statements constituted, under New York law, admissions of liability for real estate taxes on the parcels in dispute in amounts computed on the basis of the claimed valuations; and the Court, in the certiorari proceedings had no power to reduce the contested assessed valuations below the valuations stated in the petitions;

(g) pending the outcome of said judicial proceedings and for the purpose of avoiding liens, seizures, levies, penalties, interest, etc., and reserving all of its rights, plaintiff paid under protest the contested real estate taxes, as billed;

(h) the certiorari proceedings thus instituted were settled in 1951 by which it was determined that

some parts of the contested real estate taxes were properly assessed and collected and some parts thereof were improperly assessed and collected; and refunds of the real estate taxes thus determined to have been improperly assessed and collected were made by the City of New York.

[fol. 9] 7. With respect to the parcels involved in the proceedings referred to in paragraph 6(f), the totals, as taken from the books and records of the plaintiff, of

—the disputed valuations thereon, as per original assessment.

—the claimed correct valuations and over-valuations thereon as stated in plaintiff's protests filed with the New York City Tax Commission and as alleged in plaintiff's petitions for review filed in the State Courts,

—the assessed valuations thereon as finalized by the City Tax Commission,

—the contested real estate taxes thereon that were paid,

—the parts of said contested real estate taxes which the City refunded to the plaintiff pursuant to the settlement; and

—the parts of said contested real estate taxes which were by said settlement finally determined to have been properly assessed

are set forth in the schedule appearing in this paragraph. The figures appearing therein are subject to the right of the defendant to make such check and verification as it may deem necessary and as is hereinafter set forth, which right is expressly reserved to the defendant.

Disputed Tentative Assessed Valuations (1)	Over-Valuations Claimed in Protests (2)	Correct Valuations Claimed in Protests (1 minus 2) (3)	Final Assessed Valuations on the Properties in Dispute (4)	Over-Valuations Claimed in the Certiorari Proceedings (5)	Correct Valuations Claimed in the Certiorari Proceedings (4 minus 5) (6)	Amounts of Real Estate Taxes Paid That Were Contested (7)	Amounts of Said Contested Real Estate Taxes Refunded to Plaintiff (8)	Amounts of Said Contested Real Estate Taxes as Finally Determined to Have Been Proper (7 minus 8) (9)
$ 63,073,600	$ 10,268,400	$ 52,805,200	$ 63,073,600	$ 10,268,400	$ 52,805,200	$ 292,250.27	$ 66,145.00 (a)	$ 79,980.13 (b)
410,765,900	97,356,150	313,409,750	410,527,400	97,284,250	313,243,150	2,925,546.94	1,020,232.50	1,905,314.44
122,844,100	108,615,750	314,228,350	422,844,100	108,615,750	314,228,350	3,239,580.43	764,162.50	2,475,417.93
436,573,000	105,907,420	330,665,580	436,573,000	105,907,420	330,665,580	3,156,256.61	465,522.50	2,690,734.11
413,409,200	101,096,420	312,312,780	413,371,200	101,058,420	312,312,780	3,270,292.22	171,872.50 (c)	1,463,273.61 (d)

(a) This figure represents one-half of $122,290.00 the total fiscal year disputed Real Estate Taxes refunded to Plaintiff, because only the second half of said Real Estate Taxes is involved in the present suit.

(b) This figure represents one-half of $159,960.27 the total fiscal year disputed Real Estate Taxes finally determined to have been proper, because only the second half of said Real Estate Taxes is involved in the present suit.

(c) This figure represents one-half of $343,745.00, the total fiscal year disputed Real Estate Taxes refunded to Plaintiff, because only the first half of said Real Estate Taxes is involved in the present suit.

(d) This figure represents one-half of $2,926,547.22, the total fiscal year disputed Real Estate Taxes finally determined to have been proper, because only the first half of said Real Estate Taxes is involved in the present suit.

[fol. 11] 8. The figures appearing in columns 8 and 9 of the schedule in paragraph 7, supra, showing the amounts of the contested real estate taxes which were refunded to plaintiff, and the amounts thereof which were determined to have been properly assessed and collected, are on the basis of the New York City fiscal year; and are allocable on a calendar year basis, as follows:

	Applicable to New York City Fiscal Year	Applicable to Calendar Years				
		1947	1948	1949	1950	Total
	(1)	(2)	(3)	(4)	(5)	(6)
Amount of Disputed Real Estate Taxes Refunded to Plaintiff						
July 1-1946 to June 30-1947	$ 132,290.00	$ 66,145.00 (A)	$	$	$	$ 66,145.00
July 1-1947 to June 30-1948	1,020,232.50	510,116.25	510,116.25			1,020,232.50
July 1-1948 to June 30-1949	764,162.50		382,081.25	382,081.25		764,162.50
July 1-1949 to June 30-1950	465,522.50			232,761.25	232,761.25	465,522.50
July 1-1950 to June 30-1951	343,745.00				171,872.50 (B)	171,872.50
Total—		$ 576,261.25	$ 892,197.50	$ 614,842.50	$ 404,633.75	$2,487,935.00
Finally Determined to Have Been Proper						
July 1-1946 to June 30-1947	$ 159,960.27	$ 79,980.13 (A)	$	$	$	$ 79,980.13
July 1-1947 to June 30-1948	1,905,314.44	952,657.22	952,657.22			1,905,314.44
July 1-1948 to June 30-1949	2,475,417.93		1,237,708.97	1,237,708.96		2,475,417.93
July 1-1949 to June 30-1950	2,690,734.11			1,345,367.06	1,345,367.05	2,690,734.11
July 1-1950 to June 30-1951	2,926,547.22				1,463,273.61 (B)	1,463,273.61
Total—		$1,032,637.35	$2,190,366.19	$2,583,076.02	$2,808,640.66	$8,614,720.22

(A) Only Second Half Involved in Federal Income Tax Refund Suit

(B) Only First Half Involved in Federal Income Tax Refund Suit

[fol. 12] 9. The $2,487,935, representing the total amount of disputed real estate taxes refunded to plaintiff, and the $8,614,720.22, representing the total amount of disputed real estate taxes finally determined to have been properly assessed and collected as set forth in column 6 of the schedule in paragraph 8, supra, represent the same disputed and contested real estate taxes referred to respectively in paragraphs 3(a) and 3(b), supra.

10. To facilitate the presentation and consideration of the facts and legal issue involved herein, it is stipulated that the illustrative example, set forth below, illustrates the factual background in which the issue of law presented herein arises. A similar illustration was stipulated by the parties and adopted by the Court of Claims in the prior suit (see Finding No. 42, 133 Ct. Cls. 376, 399).

The example, which is applicable to all of the years involved herein, is as follows:

(a) for the year 1949 plaintiff was notified, on January 25, 1949, of a tentative assessment in the amount of	$100.
(b) plaintiff duly filed by March 15, 1949, a bona fide protest, admitting liability of	85.
and petitioning for an administrative reduction of said tentative assessment by	15.
(c) after hearing duly held and on or about May 25, 1949, final assessment was made in the amount of	100.
[fol. 13] (d) thereafter on or about October 1, 1949, under protest and for the stated purpose of avoiding liens, seizures, levies, penalties, interest, etc., and reserving all rights, payment was made of	$100.
(e) on October 25, 1949, certiorari proceedings were duly instituted in the New York Supreme Court admitting liability of, and denying liability in excess of	85.
(f) in December, 1951, the certiorari proceedings were settled, fixing the tax liability at	95.
and establishing an overpayment which was duly refunded, in the amount of	5.

11. The legal issue raised herein, in terms of the illustrative example, is as follows:

(a) whether plaintiff is entitled to a deduction in 1951 of $10, which represents that portion of the disputed $15 which was determined in 1951 to have been properly assessed, and

(b) whether there was erroneously included in plaintiff's 1951 taxable income $5, which represents that portion of the disputed $15 which was determined in 1951 to have been improperly assessed and which was refunded to plaintiff.

12. In the event a motion for summary judgment is made herein on the basis of this stipulation and the plaintiff finally prevails upon the question of law thus presented, the Government shall have ninety days after the decision of the Court has become final within which to check the correctness of the figures shown in the schedules in paragraphs 7 and 8, supra, and to notify [fol. 14] plaintiff of any error it may have discovered. If no such notice of error is given, the plaintiff shall be entitled to have judgment entered accordingly. If the Government gives such notice of error, said notice shall specify the particular errors it claims to have discovered and the parties shall have thirty days after such notice within which to agree upon the correction of the designated errors; and if agreement thereon is not had within said thirty days, either party shall have the right to apply to the Court for the appointment of a referee to hear and determine the correct amounts of said figures in dispute, or for such other method of resolving the dispute as the Court may deem proper; and upon the Court's approval of the referee's report, or such other method of resolving the dispute, judgment may be entered herein based upon the figures used herein as modified or corrected by said referee's report or other method determined by the Court.

13. The pendency of any such investigation, verification, or recomputation shall not be construed by either party to prevent the other party from taking such steps as it may deem necessary to secure appellate review of

any interlocutory decision of this Court under 28 U. S. C. 1292(b) or otherwise.

Dated: New York, N. Y.

June 23, 1959

(Signed by attorneys for the respective parties.)

[fols. 15-59] • • •

[fol. 60] IN UNITED STATES DISTRICT COURT

V

THE PLEADINGS

COMPLAINT

The plaintiff, Consolidated Edison Company of New York, Inc., by its attorneys, Whitman, Ransom & Coulson, complaining of the defendant herein, respectfully alleges upon information and belief:

1. Plaintiff is and at all times hereinafter mentioned was a public utility corporation duly organized and existing under and by virtue of the laws of the State of New York, having its principal place of business at 4 Irving Place, in the Borough of Manhattan, City, County and State of New York, and within the Southern District of New York; and is engaged in the manufacture, distribution and sale of electrical energy, gas and steam.

2. This action is brought under Title 28, U. S. C. §1346(a).

3. Plaintiff has at all times hereinafter mentioned filed its Federal income tax returns on an accrual and on a calendar year basis with the Collector of Internal Revenue and with the District Director of Internal Revenue for the district in which plaintiff maintained its principal place of business.

4. On June 13, 1952, pursuant to an extension duly granted, plaintiff duly filed its completed Federal income tax return for the calendar year 1951 disclosing an income tax liability of $30,310,237.76, which amount was assessed [fol. 61] and duly paid to the then Collector of Internal Revenue for the Second District of New York and the then District Director of Internal Revenue of New York, Lower Manhattan, in installments as follows:

March 17, 1952	$10,868,000.00
June 13, 1952	10,349,166.43
September 15, 1952	4,546,535.67
December 15, 1952	4,546,535.66
Total	$30,310,237.76

5. Thereafter, the Commissioner of Internal Revenue, after audit of plaintiff's income tax return for the calendar year 1951, assessed a deficiency of income tax for that year against plaintiff in the principal amount of $191,657.88, which amount together with deficiency interest thereon of $35,519.72, making a total of $227,177.60, was duly paid by plaintiff to the then Acting District Director of Internal Revenue of New York, Lower Manhattan, on July 5, 1955.

6. On February 10, 1955 plaintiff duly filed with the then District Director of Internal Revenue of New York, Lower Manhattan, a claim for refund on account of its overpayment of Federal income taxes for the calendar year 1951 in the amount of $5,769,159.92. A copy of said claim for refund is hereto annexed, marked Exhibit A and made a part hereof as if herein set forth at length.

7. On March 15, 1955 plaintiff duly filed with the then District Director of Internal Revenue of New York, Lower Manhattan, (3) a claim for refund on account of its overpayment of Federal income taxes for the calendar [fol. 62] year 1951 in the amount of $30,310,237.76. A copy of said claim for refund is hereto annexed, marked Exhibit B and made a part hereof as if herein set forth at length.

8. This suit is predicated upon the same bases as those stated in said refund claims, namely (1) the improper increase of plaintiff's net income for 1951 by $2,597,364.00, which amount represents the aggregate of refunds received by plaintiff in that year from the City of New York on account of overpayments of real estate taxes made to the City of New York for the years 1943 to 1950 inclusive; (2) the failure to deduct $8,770,438.80, as real estate taxes accrued and which were allowable as a deduction in 1951, which amount represents the accrual of the aggregate of those portions of the disputed and contested New York City real estate taxes of the plaintiff for the years 1943 to 1950 inclusive, which were determined in 1951 by order of the Supreme Court of the State of New York to be due the City of New York; and (3) the failure to deduct for depreciation on account of Special Obsolescence $1,005,771.40 covering the retirement in place of four motor driven reciprocating gas

compressor, motors and related equipment at the Hunts Point Gas Manufacturing Plant of plaintiff and which were allowable as a deduction in 1951.

9. The then District Director of Internal Revenue of New York, Lower Manhattan, gave plaintiff statutory notice of rejection of the above mentioned claims for refund in the amounts of $5,769,159.92 and $30,310,237.76 by registered letters dated March 28, 1955 and May 9, 1955, respectively.

[fol. 63] 10. By reason of all of the foregoing, plaintiff is legally and justly entitled to receive from defendant the sum of $30,310,237.76, or so much thereof as may ultimately be determined to have been erroneously, illegally and wrongfully exacted, collected and withheld from plaintiff, together with interest thereon as provided by law.

WHEREFORE, plaintiff demands judgment against defendant in the sum of $30,310,237.76, or so much thereof as may be legally refundable, together with interest thereon as provided by law, and the costs and disbursements of this action.

WHITMAN, RANSOM & COULSON

By JAMES K. POLK
A partner of said firm
Attorneys for Plaintiff
No. 40 Wall Street
New York 5, New York

EXHIBIT A

CLAIM

TO BE FILED WITH THE DISTRICT DIRECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID

Name of taxpayer or purchaser of stamps CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.
Street address 4 Irving Place
City, postal zone number, and State New York 3, New York

[fol. 64] 1. District in which return (if any) was filed New York Lower Manhattan, (2nd District)
2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from Jan. 1, 1951, to Dec. 31, 1951
3. Kind of tax Income Tax
4. Amount of assessment, $30,310,237.76 dates of payment See "Rider" Attached
6. Amount to be refunded $5,769,159.92

The claimant believes that this claim should be allowed for the following reasons:

For basis of claim, see "Rider" annexed hereto and incorporated herein and made a part hereof.

I declare under the penalties of perjury that this claim (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is true and correct.

Signed CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.

C. E. EBLE
Vice President

Dated February 10, 1955

[fol. 65] RIDER

The taxpayer is a public utility corporation organized and existing under and by virtue of the laws of the State of New York and is engaged in the manufacture, distribution and sale of electrical energy and gas. It keeps its books of account and files its Federal income tax returns on a calendar year and accrual basis.

During the period of 1943 to 1951 inclusive, taxpayer and its subsidiaries (excluding its wholly owned subsidiary New York Steam Corporation) owned real estate within the City of New York which together with the improvements erected thereon were valued by the City of New York for the purposes of real estate of corporations taxes in varying amounts at an aggregate low of

$472,192,350 for the fiscal year 1946/1947 and an aggregate high of $549,200,750 for the fiscal year 1950/1951.*

During this period, the City of New York was on a fiscal year basis, from July 1 to the following June 30. Each parcel of real estate, identified by Section, Block, Lot and Identification number, was appraised annually by the City Tax Commission as of January 25 and placed upon a tentative (7) assessment roll, which was open for inspection from February 1 to March 15. During this period an aggrieved owner could seek an administrative review by filing with the Tax Commission a protest and sworn application for the correction of any claimed erroneous valuation, setting forth the grounds and bases thereof and could request an oral hearing thereon. A requisite and essential part of the protest was a state-
[fol. 66] ment by the owner of the amount that was believed to be the full value of the property on January 25. A final determination had to be made by the Tax Commission on or before May 25 and if no such determination had been made by that time, the tentative valuations placed upon the assessmnet roll became final.

The assessment roll was then sent to the Comptroller of the City of New York who, between June 20 and June 25 prepared a proposed budget for the ensuing fiscal year and submitted same, together with the assessment roll and his estimates of revenues to be raised from all sources including real estate taxes, to the City Council. On the basis thereof the Council, by June 25, had to adopt a budget for the ensuing fiscal year and to fix the real estate tax rate for that year, which, when applied to the final valuations on the assessment roll would, together with the other estimated receipts, produce the necessary revenue to meet the operating and budgetory requirements of the City for that year.

Bills for the real estate tax on each parcel—the product of the tax rate thus established and the final valuations on the assessment roll—were then sent to each owner and

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*** In 1945 these subsidiaries were merged into taxpayer. Prior thereto consolidated Federal income tax returns were filed. For convenience, they will be treated as part of taxpayer for the entire period.**

became payable in two instaliments, October 1 and April 1 of the fiscal year. Failure to pay the real estate tax when due created a lien in favor of the City against the property involved.

An aggrieved property owner could obtain a judicial review of the protested assessment only if he had exhausted the administrative procedure above outlined and had properly instituted a court proceeding by October 25 in the year the assessment became final. The petition filed in such proceeding had to allege, among other things, [fol. 67] the basis upon which the relief was sought and the full value as of January 25 that the owner claimed for the property. The value thus claimed or admitted by the owner became the minimum value of the property that could be found by the Court.

Under the law of New York, the only proper and lawful real estate tax on any parcel of real estate, the valuation of which is in litigation, is the product of the established tax rate as above outlined (which once established does not vary for the particular fiscal year) and the value of the property as ultimately determined in the litigation. However, the institution or pendency of such litigation does not postpone the dates (9) upon which the bills for the real estate taxes become due and payable and does not remove or suspend the lien upon the property which arises when the tax bills are not paid when due. Such a tax lien has the force and effect of a judgment lien that could be foreclosed and the property sold.

There is no provision in the law of New York by which the tax lien could be removed or suspended, whether by injunction, bond, or otherwise, except by payment of the billed tax when due. Under the New York law an aggrieved property owner, no matter how valid his grievance, must first pay the real estate tax as billed and then seek rectification of the error by the exclusive statutory remedy as above outlined, or else run the risk of having the tax lien on the property foreclosed and the property sold, in addition to incurring a 7% interest penalty.

The present claim for refund is identical in principle with that part of the claim for refund of 1941 Federal income taxes which dealt with the treatment therein of [fol. 68] the real estate taxes of the City of New York,

and which was rejected by the Commissioner. With respect to that claim, the facts are similar to those involved herein. In 1941, the litigation that was pending between the City of New York and taxpayer (and its subsidiaries) with respect to the valuation of taxpayer's properties for the years 1938, 1939 **, 1939/1940 and 1940/1941 was finally brought to an end. The amounts of (a) the final valuation on the properties (10) in dispute assessed by the City, (b) the valuations admitted by taxpayer in its protests and petitions, (c) the overvaluations claimed by taxpayer in its protests and petitions, (d) the amounts of the contested valuations that were finally upheld in said proceedings, and (e) the amounts by which the contested valuations were reduced by the final determinations therein *** are set forth in Schedule A, annexed hereto.

Taxpayer paid the real estate taxes when due in full based upon the final assessed valuations made by the City, without regard to the protests and then pending litigation with respect thereto and took deductions for same in its Federal income tax returns as set forth in Schedule B, annexed hereto.

The real estate valuations as admitted by taxpayer in the then pending litigation; as contested therein; as upheld and adopted by the Court; and as reduced by the Court, expressed in terms of the real estate tax deductions set forth in Schedule B, are set forth in Schedule C, annexed hereto.

[fol. 69] For purposes of simplification, these various figures, when reduced to a unit of $100, may be expressed as follows:

a) Amount of real estate taxes, assessed, paid and taken as a deduction in the Federal income tax return	$100.
b) Amount of liability therefore admitted	85.
c) Amount of liability therefor denied	15.

** The City changed from a calendar year to a fiscal year on July 1, 1939.

*** Suits between the City and taxpayer's subsidiaries for the years 1938, 1939, 1940 and 1941 were similarly determined and disposed of.

(11)

d) Amount of the disputed liability, found by Court to be valid 10.

e) Amount of the disputed liability, found by the Court to be invalid and refunded to taxpayer in 1941 5.

Upon final audit of taxpayer's return, the Commissioner of Internal Revenue allowed taxpayer, pursuant to I.T. 3491, 1941—2 C.B. 177, as deductions for real estate taxes in each of the years 1938, 1939 and 1940, amounts equivalent to the hypothetical $95, and pursuant to G.C.M. 25298, 1947—2 C.B. 39 and I.T. 3863 issued thereon, 1947—2 C.B. 141, the Commissioner included in taxpayer's 1941 income tax returns the amounts equivalent to the refunds of the hypothetical $5.

Claims for refunds for the years 1938, 1939 and 1941 were duly filed and suits thereon were duly instituted and are still pending in the United States Court of Claims (Nos. 49654, 49655 and 50432), wherein taxpayer claims that only the admitted tax liabilities ($85.) are accruable and deductible for income tax purposes in the years assessed; that the unadmitted and contested tax liabilities [fol. 70] are contingent and not accruable nor deductible until the contest is resolved by final Court determination or otherwise; that it is accruable and deductible only in the year of such determination, and to the extent that it is determined that such liability exists and is valid ($10.); and that the amount refunded as a result of that determination ($5.) does not constitute income in the year of receipt. The claims for refund were rejected on the basis of G.C.M. 25298 and I.T. 3863, supra.

(12)

The position which the Commissioner has taken in these pending suits adheres to said G.C.M. 25298, and I.T. 3863, supra; namely, that the amount of real estate taxes paid in any year is deductible in the year of payment regardless of the fact that liability therefor is denied and contested, and that the amount of the unadmitted and contested liability for the real estate taxes that is refunded

as a result of the termination of the litigation in respect thereto, is includible in gross income in the year of receipt.

The present claim for refund of income taxes for the year 1951, as hereinafter set forth, is based upon the treatment for income tax purposes of the final determination and settlement effected in 1951 of the then pending litigation with respect to the unadmitted and contested real estate taxes for the years 1943 to 1951 inclusive, and is identical in principle with the issues raised and now pending in the United States Court of Claims for the years 1938, 1939 and 1941.

For the fiscal years ending June 30, 1944 to June 30, 1951 inclusive, the City of New York complied with the provisions of law with respect thereto, as hereinabove outlined with respect to valuations for real estate tax [fol. 71] purposes, and made timely, final assessments of valuations of real property in the City of New York, and duly established the tax rates thereon for each of the respective fiscal years. In due course bills were sent to taxpayer based thereon for each of the parcels of real estate in the City of New York owned by taxpayer in said respective years.

(13)

In each of said years taxpayer duly filed protests to some of the valuations set forth on the tentative assessment rolls with respect to certain of its properties, which protests were rejected by the City of New York. Taxpayer then duly paid under protest the full amount of the tax bills issued by the City for the real estate taxes levied upon the properties on their respective due dates. The payments were involuntarily made under compulsion of the law to avoid any tax liens arising upon its properties, and to avoid any penalties, and were made without prejudice to any of its rights, and without admission of liability for, or validity of, the purported assessments upon said properties or taxes levied thereon.

Thereafter, taxpayer duly instituted, in each of the years of assessment and payment of said taxes, timely suits for judicial review of said assessments, setting forth therein, as it did in the protests to said assessments as

originally filed with the Tax Commission, the full value of each parcel that was in dispute.

In 1951, there were pending in the Supreme Court of the State of New York duly instituted suits for the judicial review of the final assessed valuations of some of taxpayer's real estate properties in each of the City fiscal years 1943/1944 to 1950/1951 inclusive. In 1951, [fol. 72] those pending suits were finally resolved and final orders were entered therein determining the proper final valuations of the parcels in dispute for each of the years in suit, which valuations were somewhat lower than that determined by the Tax Commission but somewhat greater than that admitted and claimed (14) by taxpayer. This resulted in a real estate tax liability with respect to each of the parcels of real estate in dispute for each of the years involved in amounts somewhat greater than originally admitted by taxpayer, but somewhat less than the amounts originally asserted by the City and paid by taxpayer. The excess of the real estate taxes thus determined to have been paid in the prior years were refunded to taxpayer in 1951.

Annexed hereto as Schedule D are tabulations showing

(a) Total assessed value on all properties owned by taxpayer,
(b) Final valuations of the properties in dispute, as assessed by the City ($100),
(c) Values admitted by taxpayer ($85),
(d) Overvaluations claimed by taxpayer ($15),
(e) Contested valuations held valid by the Court ($10), and
(f) Contested valuations held invalid and reduced by the Court in the final orders entered in the pending litigation ($5).

(15)

The full amounts of the real estate taxes as billed by the City for the parcels of real estate that were in controversy were paid and deductions for same were taken [fol. 73] by taxpayer in its Federal income tax returns as set forth in Schedule E, annexed hereto.

The real estate valuations of the properties in controversy, as admitted by taxpayer in the then pending litigation; as contested therein by taxpayer; as upheld and finally adopted by the Court; and as reduced and held invalid by the Court, expressed in terms of the real estate taxes taken as income tax deductions in the years 1943 to 1950, inclusive as shown in Schedule E, are as set forth in Schedule F, annexed hereto.

Taxpayer filed a tentative Federal income tax return for the calendar year 1951 on or about March 17, 1952, disclosing an estimated tax liability of $30,987,000.00. On or about June 13, 1952 taxpayer filed its final return for the calendar year 1951, disclosing a tax liability of $30,310,237.76 which was paid in installments as follows:

March 17, 1952	$10,868,000.00
June 13, 1952	10,349,166.43
September 15, 1952	4,546,535.67
December 15, 1952	4,546,535.66
	$30,310,237.76

(16)

Included in said final income tax return for 1951 was a deduction for all kinds of taxes accrued during that year, aggregating $54,914,777.40. Included therein was a net figure of $15,777,378.95 arrived at as follows:

Total Real Estate Taxes Accrued in 1951	$18,374,742.94
Refund of Real Estate Taxes deducted in 1943 to 1950, inclusive, received in 1951	2,597,364.00
Net	$15,777,378.94

[fol. 74] This treatment of the refund of the real estate taxes from the City of New York increased the net income of taxpayer for the year 1941 to the same extent as if said refund had instead been included in taxpayer's gross income for that year; and had the same income tax effect for that year as did the Commissioner's inclusion of the hypothetical $5 in taxpayer's gross income in 1941 supra.

Taxpayer claims that this treatment of the refund of

the real estate taxes in 1951, just as the Commissioner's inclusion of the $5 in taxpayer's gross income for 1941, supra, is erroneous and improper; and, for the same reasons as claimed in the pending suit in the United States Court of Claims, erroneously and improperly increases the taxpayer's net income for the year 1951 by $2,597,364.00. The refund is in effect a return of a deposit for taxes and has no bearing or effect on taxpayer's taxable income for that year.

Taxpayer further claims that the $8,770,438.80 (column (d) of Schedule "F", which is the equivalent of the (17) hypothetical $10 in the illustrative example, supra), which is the portion of the unadmitted and contested real estate taxes that was first determined to be due in 1951 when the pending suits against the City of New York were finally terminated, is a proper deduction in 1951 when taxpayer's liability therefor was first fixed and determined—liability therefor having until then been contingent pending the outcome of said suits. However, no deduction for this amount was taken in the return. This [fol. 75] claim of taxpayer is identical with that made by taxpayer with respect to its claim for refund of its 1941 income taxes, and which was rejected by the Commissioner on the basis of G.C.M. 25298 supra and I.T. 3863, supra, and which is the basis of the suit now pending in the United States Court of Claims.

Taxpayer in this claim for refund relies upon the principles enunciated by the Supreme Court in *Dixie Pine Products Co.* v. *Commissioner,* 320 U. S. 516 (1944) and *Security Flour Mills Co.* v. *Commissioner,* 321 U. S. 281 (1944) to the same extent as it did in its 1941 claim for refund. The same reasons advanced by taxpayer in the pending Court of Claims case for considering the Commissioner's rejection of its claim for refund for 1941 to have been erroneous and improper, are advanced herein in support of this claim.

By reason of all of the foregoing, taxpayer's net income for the taxable year 1951 has been overstated by $11,367,802.80 and the Commissioner of Internal Revenue has erroneously, improperly and illegally collected from taxpayer as income taxes for the year 1951 the sum of $5,769,159.92.

[fol. 76]

Orig—
2/21/55

REVISED COMPUTATION OF TAX LIABILITY—
YEAR 1951

Net Income—per Return Filed		$62,576,391.06
Less asserted overstatement of Income—Page 12 of Claim		11,367,802.80
		$51,208,588.26
Less: Dividend Credit etc. per Return		2,840,821.60
		48,367,766.66
Effective Rate		50.75%
Revised Tax Liability (Before Statutory Items)		24,546,641.58
Less—Statutory Exemption	5,500.00	
—Tax Free Interest	63.74	5,563.74
(Page 3—Return)		
Revised Tax Liability		24,541,077.84
Paid under Original Return		30,310,237.76
Overpayment of Tax		(5,769,159.92)

[fol. 77]

SCHEDULE "A"

	1938	1939	1939/1940	1940/1941
a) Assessed Value	$410,985,375	$416,635,375	$407,040,350	$402,707,900
b) Admitted Value	294,449,375	304,592,475	301,180,650	283,329,800
c) Claimed Over-valuation	116,536,000	112,042,900	105,859,700	119,378,100
d) Contested Value Upheld	90,841,000	86,247,900	89,269,700	104,723,100
e) Contested Value Reduced By	25,695,000	25,795,000	16,590,000	14,655,000

[fol. 78]

SCHEDULE "B"

Paid and Deducted in

Real Estate Taxes	1938	1939	1940	1941
First half 1938	$ 6,034,455.26			
Second half 1938	6,032,679.75			
First half 1939		$ 6,021,790.73		
First half 1939/1940		6,004,087.07		
Second half 1939/1940			$ 5,973,284.69	
First half 1940/1941			6,022,816.87	
Second half 1940/1941				$ 5,802,254.04
First half 1941/1942				5,677,127.89
Total	$12,067,225.01	$12,025,877.80	$11,996,065.56	$11,479,381.93

[fol. 79]

SCHEDULE "C"

	1938	1939	1940	Total
a) Real Estate tax deduction taken in Fed. I. T. Returns	$12,067,225.01	$12,025,877.80	$11,996,065.56	$36,089,168.37
b) Admitted Liability	8,643,986.47	8,868,859.86	8,649,144.65	26,131,990.98
c) Contested Amount	3,423,238.54	3,187,017.94	3,346,920.91	9,957,177.39
d) Contested Amount Held Valid by Court	2,664,927.54	2,567,757.69	2,878,812.41	8,108,497.64
e) Contested Amount Held Invalid by Court and Refunded in 1941	758,311.00	622,260.25	468,108.50	1,848,679.75

[fol. 80]

SCHEDULE "D"

	Total Assessed Value On All Properties	Total Assessed Value On Disputed Property ($100)	Admitted Value ($85)	Claimed Over-valuation ($15)	Contested Value Upheld ($10)	Final Reduction ($5)
1943/1944	$506,782,775	$ 3,573,900	$ 2,118,400	$ 1,455,500	$ 495,500	$ 960,000
1944/1945	515,453,025	5,631,600	5,139,400	492,200	492,200	—
1945/1946	493,427,850	36,370,900	34,228,800	2,142,100	1,642,100	500,000
1946/1947	472,192,350	63,073,600	52,805,200	10,268,400	5,618,400	4,650,000
1947/1948	497,541,450	410,527,400	313,243,150	97,284,250	63,359,250	33,925,000
1948/1949	508,458,750	422,844,100	314,228,350	108,615,750	82,990,750	25,625,000
1949/1950	525,299,450	436,573,000	330,665,580	105,907,420	90,282,420	15,625,000
1950/1951	549,200,750	413,371,200	312,312,780	101,058,420	90,433,420	10,625,000

[fol. 81]

SCHEDULE "E"

Real Estate Taxes On Parcels in Controversy	Paid and Deducted in 1943	1944	1945	1946
First half 1943/1944	$ 54,492.93			
Second half 1943/1944		$ 54,492.93		
First half 1944/1945		81,939.78		
Second half 1944/1945			$ 81,939.78	
First half 1945/1946			512,726.33	
Second half 1945/1946				$ 512,736.23
First half 1946/1947				899,451.11
Total	$ 54,492.93	$ 136,432.71	$ 594,665.11	$ 1,412,187.34

	Paid and Deducted in 1947	1948	1949	1950
Second half 1946/1947	$ 899,451.11			
First half 1947/1948	6,169,749.48			
Second half 1947/1948		$ 6,169,749.47		
First half 1948/1949		6,301,134.65		
Second half 1948/1949			6,301,134.65	
First half 1949/1950			6,500,666.29	
Second half 1949/1950				$6,500,666.29
First half 1950/1951				6,689,020.53
Total	$7,069,200.59	$12,470,884.12	$12,801,800.94	$13,189,686.82

[fol. 82]

SCHEDULE "F"

Year	Real Estate Tax Deduction in Returns ($100)	Admitted Liability ($85)	Contested Amount ($15)	Contested Amount Held Valid ($10)	Contested Amount Held Invalid—Refunded in 1951 ($5)
1943	$ 54,492.93	$ 32,341.20	$ 22,151.73	$ 7,559.73	$ 14,592.00
1944	136,432.71	107,119.48	29,313.23	14,721.23	14,592.00
1945	594,665.11	557,306.61	37,359.50	30,309.50	7,050.00
1946	1,412,187.34	1,235,864.22	176,323.12	103,128.12	73,195.00
1947	7,069,200.59	5,460,301.99	1,608,898.60	1,032,637.35	576,261.25
1948	12,470,884.12	9,388,320.43	3,082,563.69	2,190,366.19	892,197.50
1949	12,801,800.94	9,603,882.42	3,197,918.52	2,583,076.02	614,842.50
1950	13,189,686.82	9,976,412.41	3,213,274.41	2,808,640.66	404,633.75
Totals	$47,729,350.56	$36,361,548.76	$11,367,802.80	$8,770,438.80	$2,597,364.00

[fol. 83] EXHIBIT B

Duplicate

CLAIM

TO BE FILED WITH THE COLLECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID

The Collector will indicate in the block below the kind of claim filed, and fill in, where required, the certificate on the back of this form

☒ REFUND OF TAXES ILLEGALLY, ERRONEOUSLY OR EXCESSIVELY COLLECTED.

Name of taxpayer or purchaser of stamps CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.

Business address 4 IRVING PLACE NEW YORK 3 NEW YORK

1. District in which return (if any) was filed Lower Manhattan—New York

2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from Jan. 1, 1951, to Dec. 31, 1951

3. Character of assessment or tax Corporation Income Tax

4. Amount of assessment, $30,310,237.76; dates of payment, Mar. 17; June 13; Sept. 15; Dec. 15, 1952

6. Amount to be refunded $30,310,237.76

[fol. 84] The claimant believes that this claim should be allowed for the following reasons:

For basis of Claim, see Schedule A annexed hereto and made a part hereof.

I declare under the penalties of perjury that this claim (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is true and correct.

Signed CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.

C. E. EBLE
VICE PRESIDENT

Dated March 15, 1955

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.

SCHEDULE A TO EXHIBIT "B"

1. The taxpayer, on or about March 17, 1952, filed a tentative return for the calendar year 1951, which reflected an estimated tax liability for the year 1951 in the amount of $30,987,000. An extension of time was obtained until June 15, 1952, within which the completed return should be filed. On June 13, 1952, the completed tax return for the year 1951 was filed. This completed return reflected a tax liability in the amount of $30,310,237.76. [fol. 85] Payments were made on the basis of the completed return as follows:

March 17, 1952	$10,868,000.00
June 13, 1952	10,349,166.43
September 15, 1952	4,546,535.67
December 15, 1952	4,546,535.66

2. Under Section 6511—of the Internal Revenue Code of 1954 refunds of overpayments may not be made unless a Claim for Refund is filed by the taxpayer within three years from the time the return was filed, or two years from the time the tax was paid. Accordingly, a Claim for Refund is hereby made within the statutory period for the taxable year 1951.

3. The completed return of the taxpayer for the taxable year 1951 has been audited by the Internal Revenue Service, but the Revenue Agent's Report of his adjustments to taxable income, has not been received to date. However, on March 14, 1955, at the request of the Revenue Agent; Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment (Form 870) covering additional tax for the year 1951 in the amount of $191,657.88, was executed and filed with the Internal Revenue Service. Also at the request of the Revenue Agent, a consent fixing Period of Limitation upon Assessment of Income and Profits Tax (Form 872) until June 30, 1956, will be executed and filed by the taxpayer for the year 1951 with the Internal Revenue Service within the next few days.

[fol. 86] 4. Under date of February 10, 1955, a Claim for Refund was filed by the taxpayer with the Internal Revenue Service, for the refund of income taxes for the year 1951, in the amount of $5,769,159.92 or for any such greater amount as is legally refundable. The basis of this claim was the erroneous inclusion as taxable income the refund received in respect of disputed real estate taxes for the year 1943 through 1950, settled in 1951. The purposes of filing this claim were to associate this refund received in 1951 with a similar type of refund received in 1941 forming the basis of suit now pending in the United States Court of Claims, No. 50432, and to institute immediate suit before that court for the 1951 settlement, thereby formally bringing before the Attorney General of the United States for consideration the single issue of disputed real estate taxes of the taxpayer for the period—year 1938 through 1950.

The present Claim for Refund is supplementary to the Claim for Refund under date of February 10, 1955, referred to above, and by this reference incorporates in this Claim for Refund all the statements made in the February 10, 1955 Claim that the taxable net income of the taxpayer for the year 1951 was overstated by the erroneous inclusion as income the refund received in 1951 in respect of disputed real estate taxes for the year 1943 through 1950, settled in 1951.

5. In the completed tax return of the taxpayer for the year 1952, filed June 15, 1953, there was claimed under Deductions—Item 25—Depreciation, the amount of $36,400,000.00. This amount among other things included an [fol. 87] item of Special Obsolescence, amount $1,005,771.40 covering the retirement in place of four motor driven reciprocating gas compressors, motors and related equipment at the Hunts Point Gas Manufacturing Plant. (28)

These facilities were physically disconnected and made inoperative in June 1951. Up to that time, this equipment had been used in blowing water gas in the 24" high pressure mains serving certain portions of Bronx and Westchester Counties. With the introduction, however, of natural gas into these areas, occasioning the conversion of the carburetted water gas sets at the Pelham Gas Manufacturing Plant to the manufacture of oil gas of approximately 1,000 BTU per cubic foot, the use of the compressors in question for blowing purposes were no longer needed.

While the four compressors etc. were disconnected in June 1951, their retirement was not authorized by the Board of Trustees until July 1952. The delay of approximately a year in authorizing their abandonment was due to the consideration of their possible re-use elsewhere on the system. Management had not completed its system study of natural gas distribution until July 1952 or thereabouts, at which time it became known these facilities would not be needed in the ultimate gas program of the taxpayer. The calculation to determine the deduction for special obsolescence was made, therefore, in the light of the above circumstances. The deduction in the amount of $1,005,771.40 was considered therefore as reasonably applicable to the year 1952.

[fol. 88] Should it be asserted in final review of the audit of the completed return of the taxpayer for the year 1951, or in the field audit of the completed return for the year 1952 yet to be made, that the deduction for special obsolescence in respect of these facilities should relate to the year 1951 in whole or in part, to the extent that the amount of income tax for the year 1951 as finally

determined by the Internal Revenue Service includes an allowance for this transaction in its computation of tax liability, the income tax for the year 1951 was consequently overpaid, and Claim for Refund is hereby made.

6. The taxpayer will assemble and furnish any further information and data, in respect of the several transactions supporting this Claim for Refund, that may be required for the proper determination of this Claim. The taxpayer requests an opportunity to discuss this Claim for Refund when it is reached for consideration.

[fol. 89] IN UNITED STATES DISTRICT COURT

ANSWER

(35)

Defendant, by its attorney, Paul W. Williams, United States Attorney for the Southern District of New York, alleges as follows for its answer to plaintiff's complaint:

1. Admits the allegations in paragraph 1.
2. Admits the allegations in paragraph 2.
3. Admits the allegations in paragraph 3.
4. Admits the allegations in paragraph 4.
5. Admits the allegations in paragraph 5.
6. Admits the allegations in paragraph 6,

except specifically to deny all statements of fact in Exhibit A not otherwise specifically admitted in this answer, and to deny that there was in fact an overpayment.

7. Admits the allegations in paragraph 7, except specifically to deny all statements of fact in Exhibit B not otherwise admitted in this answer, and to deny that there was in fact an overpayment.

8. Denies the allegations in paragraph 8, except to admit that the alleged grounds for recovery in this suit are the same grounds set forth in the refund claims filed on February 10 and on March 15, 1955.

(36)

9. Admits the allegations in paragraph 9.
10. Denies the allegations in paragraph 10.

[fol. 90] AFFIRMATIVE DEFENSE

11. This action is barred by virtue of the fact that the same causes of action, issues, and facts that are asserted by the complaint were or could have been raised in previous actions between this plaintiff and this defendant, which previous actions resulted in a judgment adverse to the plaintiff. The prior actions are reported as Court of Claims Nos. 49654, 49655 and 50432, *Consolidated Edison Co. of New York* v. *United States;* the opinion of the Court is reported at 135 F. Supp. 881 (Ct. Cl. 1955) *cert. denied* 351 U. S. 909; it is now final.

WHEREFORE, defendant demands judgment dismissing the complaint, together with the costs and disbursements of this action.

PAUL W. WILLIAMS,
United States Attorney for the
Southern District of New York,
Attorney for Defendant.

By: FOSTER BAM,
Foster Bam,
Assistant United States Attorney,
Office & Post Office Address:
United States Court House,
Foley Square,
New York 7, New York.

[fol. 91] (BY NOTICE OF AMENDED PLEADING FILED DECEMBER 11, 1956 THE ANSWER WAS AMENDED TO INCLUDE THE FOLLOWING AS PARAGRAPH 12.)

12. Defendant alleges that if plaintiff's contentions are sustained, either in whole or in part, under any of the alternative theories advanced in its complaint and claims for refund, that the allowance of said contention or contentions would make it necessary in the interest of consistency that a reaudit and redetermination be made of plaintiff's income and excess profits tax liabilities for all the years involved. Under the circumstances just described, adjustments of all items—including income and deductions—for all said years should be made, consistent with the final decision reached herein.

[fols. 92-94] * * *

[fol. 95] IN THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

No. 298—October Term, 1959

(Argued April 13, 1960)
Docket No. 26041

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC., PLAINTIFF-APPELLANT

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLEE

Before LUMBARD, *Chief Judge*, and SWAN and CLARK, *Circuit Judges*.

OPINION—May 25, 1960

Appeal from the United States District Court for the Southern District of New York.

Plaintiff appeals from the order and judgment of Judge Sugarman denying plaintiff's motion for summary judgment, granting defendant's motion for summary judgment, and dismissing the complaint in an action to recover an alleged overpayment of income taxes for the year 1951. Judgment reversed.

[fol. 96] WHITMAN, RANSOM & COULSON, *Attorneys for Plaintiff-Appellant*. James K. Polk, Harold F. Noneman, and Julius M. Jacobs of Counsel.

S. HAZARD GILLESPIE, JR., United States Attorney, *for Defendant-Appellee*. Arthur V. Savage, Assistant United States Attorney of Counsel.

SWAN, *Circuit Judge*:

Plaintiff-Appellant is a well-known public utility corporation which keeps its books and files its tax returns on an accrual and calendar year basis. It brought the present suit under 28 U. S. C. A. §1346(a) to recover an alleged large overpayment of federal income taxes for the year 1951. Defendant's answer to the complaint interposed a general denial and an affirmative defense of collateral estoppel. A motion for summary judgment based on the affirmative defense was denied by Judge Palmieri in 1958 in an opinion reported at 162 F. Supp. 854. Thereafter, upon amended pleadings and a stipulation which eliminated all factual issues, each party moved for summary judgment. The district judge, Judge Sugarman, before whom these motions were argued, denied plaintiff's motion, granted defendant's, and dismissed the complaint. This is the order appealed from.

The ultimate questions to be decided are two, namely, (1) whether, under §23(c) of the Internal Revenue Code of 1939, a contested real estate tax liability accrued in the year the litigation was settled, or in a prior year when the contested tax was involuntarily paid under protest; and (2) whether the receipt of a partial refund of the contested and involuntarily paid tax, constituted income to the taxpayer in the year of settlement.

[fol. 97] Before reaching the merits of these issues, it is desirable to consider defendant's contention of collateral estoppel based upon a decision of the Court of Claims which adjudicated the identical issues with respect to contested real estate taxes of earlier years. *Consolidated Edison Co. of N. Y.* v. *United States*, 133 Ct. Cl. 376, 135 F. Supp. 881, cert. den. 351 U. S. 909. The Court of Claims held that the contested taxes were deductible as a liability in the year they were paid to the City of New York, and that the amount refunded was income to the taxpayer in the year it was received from the City.[1]

---

[1] The stipulation mentioned above preserved the Government's right to raise the question of *res judicata* or collateral estoppel on any appeal taken herein.

On the issue of collateral estoppel both parties rely on *Commissioner* v. *Sunnen*, 333 U.S. 591, as they also did when that issue was before Judge Palmieri in 1958. He decided the issue adversely to defendant. We agree with his conclusion and are entirely satisfied with the reasoning of his opinion reported in 162 F. Supp. 854. As the *Sunnen* opinion states at page 601:

> "* * * And if the very same facts and no others are involved in the second case, a case relating to a different tax year, the prior judgment will be conclusive as to the same legal issues which appear, assuming no intervening doctrinal change. But if the relevant facts in the two cases are separable, even though they be similar or identical, collateral estoppel does not govern the legal issues which recur in the second case. Thus the second proceeding may involve an instrument or transaction identical with, but in a form separable from, the one dealt with in the first proceeding. In that situation, a court is free in the second proceeding to make an independent examination of the legal matters at issue. It may then reach [fol. 98] a different result or, if consistency in decision is considered just and desirable, reliance may be placed upon the ordinary rule of *stare decisis*."

Under the New York law as to real estate taxes, the assessed valuation and the tax imposed on a given parcel of land for a given year is separate from, independent of, and unconnected with the assessed valuation and tax imposed on that parcel for any other year; and the same is true with respect to the administrative and judicial proceedings by which an aggrieved owner seeks review of the contested assessed valuation and the tax on that parcel for the given year. Hence we think it obvious that "the relevant facts" in the Court of Claims case and in the case at bar "are separable, even though they may be similar or identical," and that collateral estoppel does not control the legal issues "which recur in the second case."

To facilitate the presentation and consideration of the facts and legal issues involved, the stipulation above men-

tioned set forth an illustrative example which is applicable to all the years herein involved and reads as follows:

"(a) for the year 1949 plaintiff was notified, on January 25, 1949, of a tentative assessment in the amount of ..... $100.

(b) plaintiff duly filed by March 15, 1949, a bona fide protest, admitting liability of ..... 85.

(c) after hearing duly held and on or about May 25, 1949, final assessment was made in the amount of ..... 100.

(d) thereafter on or about October 1, 1949, under protest and for the stated purpose of avoiding liens, seizures, levies, penalties, interest, etc., and reserving all rights, payment was made of ..... 100.

[fol. 99] (e) on October 25, 1949, certiorari proceedings were duly instituted in the New York Supreme Court admitting liability of, and denying liability in excess of ..... 85.

(f) in December, 1951, the certiorari proceedings were settled, fixing the tax liability at ..... 95.
and establishing an overpayment which was duly refunded, in the amount of ..... $ 5."

The government claims, in terms of the example, that the taxpayer was required to deduct the entire $100 from its gross income in 1949, the year in which the money was paid, and to include in its gross income for 1951 the $5 refunded to it by the City in that year. The taxpayer's position is that it was required to deduct in 1949 only $85, the amount of real estate tax paid and uncontested and that it should be permitted to deduct in 1951 an additional $10, the portion of the disputed $15 ultimately determined to have been properly assessed. The overall effect of the taxpayer's position would be to require the payment of a greater tax than the government claims is due in the year 1949, because of the smaller deduction, and a lesser tax in the year 1951, because of the additional $10 deduction accrued then and the absence of the

inclusion of the $5 refund in gross income. Having paid its 1951 taxes under the government's theory, the taxpayer claims that it is now entitled to a refund.

The stipulation states the legal issues raised herein, in terms of the illustrative example, as follows:

> "(a) whether plaintiff is entitled to a deduction in 1951 of $10, which represents that portion of the disputed $15 which was determined in 1951 to have been properly assessed, and
>
> [fol. 100] (b) whether there was erroneously included in plaintiff's 1951 taxable income $5, which represents that portion of the disputed $15 which was determined in 1951 to have been improperly assessed and which was refunded to plaintiff."

This illustrative example has greatly simplified the facts necessary to be stated on this appeal. It will suffice to say that appellant owns many parcels of real estate in New York City with respect to which corporate real estate taxes for each year were assessed by applying tax rates established by the City Council to final assessed valuations fixed by one City Tax Commission. In each of the years 1938 to 1950, with the exception of 1942 and 1943, the appellant contested in the manner prescribed by local law part of the taxes so imposed. The contest proceedings in respect to the years 1938-1940 were concluded in 1941 by a settlement which fixed the taxes at a somewhat lower figure than the taxes assessed, and the difference was refunded, although this was less than appellant had sought to recover.[2] A similar settlement was concluded in December 1951 of the contest proceedings instituted in respect to the years 1946-1950.

We turn now to the merits of the issues presented by the illustrative example. The sections of the 1939 Code which are involved are §§23(c), 41, 42, 43 and 48.[3] Sec-

---

[2] An illustrative example identical with the one set forth above, except for difference in dates, was stipulated by the parties and adopted by the Court of Claims in the prior suit involving the years 1938-1940.

[3] These are the same as their counterparts in the 1954 Code and in the prior Revenue Acts. Reference will be made in terms of the 1939 Code.

tion 23 allows a deduction from gross income to be taken for "taxes paid or accrued within the taxable year"—with exceptions not here material. Section 41 prescribes that net income shall be computed "in accordance with the [fol. 101] method of accounting regularly employed in keeping the books of such taxpayer," unless the method employed does not clearly reflect the income. Section 42 recognizes that items of income, though normally to be included in gross income in the taxable year of receipt, may "under methods of accounting permitted under section 41" be properly accounted for as of a different period. Section 43 says that deductions and credits "shall be taken for the taxable year in which 'paid or accrued' or 'paid or incurred,' upon the basis of which the net income is computed, * * *" Section 48 directs that "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed.

In a number of cases involving the counterparts of these sections, the Supreme Court has explained that a tax liability becomes deductible under §23(c), to a taxpayer keeping its books on the accrual basis, only when all events have occurred which determine the fact and amount of the tax liability. This "all-events rule," announced in *United States* v. *Anderson*, 269 U. S. 422, was very clearly restated in *Dixie Pine Co.* v. *Commissioner*, 320 U. S. 516, 519;

> "It has never been questioned that a taxpayer who accounts on the accrual basis may, and should, deduct from gross income a liability which really accrues in the taxable year. It has long been held that in order truly to reflect the income of a given year, all the events must occur in that year which fix the amount and the fact of the taxpayer's liability for items of indebtedness deducted though not paid; and this cannot be the case where the liability is contingent and is contested by the taxpayer. Here the taxpayer was strenuously contesting liability in the courts and, at the same time, deducting the amount of the tax, on the theory that the state's exaction constituted a fixed and certain liability. This it could

[fol. 102] not do. It must, in the circumstances, await the event of the state court litigation and might claim a deduction only for the taxable year in which its liability for the tax was finally adjudicated."

This was reaffirmed in *Security Flour Mills Co.* v. *Commissioner,* 321 U. S. 281, at 284. And *Lewyt Corp.* v. *Commissioner,* 349 U. S. 237, 242-243 states that "the concept 'accrued' embodies the annual accounting principle," and the amount of the tax accrued within the taxable year "is to be determined in accord with the normal accounting concepts relevant to the accrual basis."

Applying these cases to the issues presented by the illustrative example it is clear that the uncontested $85 of the $100 tax accrued and was deductible in 1949. Indeed, this is admitted by both parties. We think it equally clear that the contested $15 tax liability was, for income tax purposes, a contingent liability which might or might not become a fixed liability depending upon the outcome of the State litigation. In cases of a contested item of liability, accountants usually indicate the existence of contest by showing the item as contingent, or by a footnote. Ten dollars of the contested $15 became a fixed liability when the litigation terminated in 1951, and became deductible in that year. The remaining $5 never became a liability of the taxpayer. Nor was the receipt of that sum from the City in 1951 income of the taxpayer; it was the realization of an asset of contingent value purchased by the taxpayer when it paid the City the $15 it was contesting. A payment may constitute a capital expenditure, an exchange of assets, a prepaid expense, a deposit, or a current expense. When the exact nature of the payment is not immediately ascertainable because it depends on some future event, such as the outcome of litigation, its treatment for income tax purposes must await that event. Thus in *Doyle* v. *Com-*
[fol. 103] *missioner,* 2 Cir. 110 F. 2d 157, this court held that the income tax treatment of forfeited payments received under a contract to sell real estate was to be determined by, and was to be reflected in the year of the subsequent events, rather than the year in which the

payments were received; see also *Bressner Radio, Inc.* v. *Commissioner*, 2 Cir. 267 F. 2d 529.

It is true that the Supreme Court cases above cited did not involve a taxpayer who paid a contested tax during the pendency of the contest. That question was presented in the *Consolidated Edison* case in the Court of Claims, *supra*, and that Court followed its earlier decision in *Chestnut Securities Co.* v. *United States*, 104 Ct. Cl. 489, 62 F. Supp. 574 which held that "Accrual, from the debtor's standpoint, precedes payment and does not survive it." With due respect we disagree with this view. Indeed, the findings of fact with respect to applicable accounting principles which the Court of Claims made in the *Consolidated Edison* case are inconsistent with such decision.[4] The principles of accrual accounting set forth in those findings are correct. A decision supporting them will prevent a taxpayer from taking the inconsistent positions of contesting a liability and at the same time claiming a deduction for it. The position which the government urges seems to us inconsistent with the general [Vol. 104] policy of obtaining the largest amount of tax revenue at the earliest possible date. In the usual run of cases, the government's insistence that the taxpayer take his deduction in the year of paying under protest a contested liability will result in the receipt of less tax revenue in that year. For this reason (among others) in the *Chestnut Securities* case, the government took a position opposite to that here urged. The government lost that case. In following the Court of Claims without discussing the principles involved, we think Judge Sugar-

[4] See Findings Nos. 35 to 38 inclusive, particularly 38 which reads as follows: "Under accrual accounting, when payment is made with respect to a liability which is denied in whole or in part, the accounting principle as to charges against income would be the same as if payment had not been made; such payment would not affect the treatment of any accruals. This principle applies equally to the payment of taxes. The payment of admitted or estimated ultimate liability constitutes the payment of a current charge or expense of operations and the balance of that payment represents an amount estimated to be ultimately recovered and is chargeable to a suspense, deferred debit, or other receivable account. The latter item represents an asset—a deposit which is expected to be recovered."

man fell into error. In conformity with those principles summary judgment should have been entered for the plaintiff-appellant.

It is suggested in criticism of our decision that it leaves open to a taxpayer opportunities for manipulation through self-serving appraisals. Such opportunities are no greater when payment has been made under protest to prevent the attachment of liens or seizure, than when payment has not been made, as in the *Dixie Pine* case. The problem of determining whether the contest is a bona fide one is present in either situation. The criticism, we think, is really directed against the *Dixie Pine* line of decisions.

Accordingly the judgment is reversed and the cause remanded with directions to enter summary judgment for plaintiff-appellant pursuant to paragraph 12 and 13 of the stipulation of the parties.

CLARK, *Circuit Judge* (dissenting):

Apparently accountants and at least some tax lawyers agree that the Commissioner has not been appropriately hospitable to the precepts of accrual accounting and applaud tentative judicial steps toward accepting such precepts. See, e.g., Behren, *Prepaid Income—Accounting Concepts and the Tax Law*, 15 Tax L. Rev. 343 (1960), discussing *Bressner Radio, Inc.* v. *C.I.R.*, 2 Cir., 267 F. 2d 520. For my part I would not disagree and think [fol. 105] that within limits the trend to follow accounting ideas is desirable as bringing tax and business practices mutually into line. But I do feel it must stop short of delivering control of the revenue to the accountants. For accounting is not an exact science; and corporate balance sheets must deal with many fluid items, representing of course much factual information, but also a certain amount of prophecy, of hope, and of sheer argumentation. Because of this, because also the accountant does owe the duty of loyalty to his client, the result will naturally reflect the needs and desires of the client more than the appropriate demands of the tax collector, who not only must collect all the revenue due, but must hold the bal-

ance fairly and without discrimination among taxpayers. And the present holding, which goes beyond anything yet in the books, seems to me to exceed proper bounds in committing final adjudication as to the revenue to corporate accountants.

Consider the actual decision herein. It is that deductions for local tax liability are to be made, not when the liability is due *and* paid, but when some years later and after dispute the parties (not including the representative of the federal revenue) get together and adjust their difference. The opinion suggests no limitation of time or otherwise on the operation of the principle thus broadly announced; and upon reflection I can see none of any actual operative effect. It would seem that a taxpayer, by asserting a dispute as to a liability for taxes paid, may postpone the use of such payment as an income tax deduction practically indefinitely until it finds it expedient to settle the dispute with or without receipt of a refund. I presume the dispute must be honestly asserted with perhaps some indicated possibility of success. But these are such minimal requirements as to the large tax liabilities of great corporations as to be meaningless in practice. Obviously a local tax dispute can be prolonged [fol. 106] for years; and extrinsic factors such as a corporate reorganization might prolong it yet further. Moreover, I do not see how the principle can be limited only to tax payments; it would seem applicable to other disputed payments generally. Thus ascertainment of the corporate income is substantially taken out of the hands of the revenue authorities; discrimination between taxpayers is accomplished on the basis of the astuteness of the accountants employed; and the sound rule of *annual* federal tax accounting—perhaps the cornerstone of federal revenue collecting—is repudiated in a vitally important detail.

Moreover, an examination of the history of plaintiff's real estate tax controversies with the City of New York for the fiscal years here involved indicates that the result reached by the majority does not even accord with generally accepted accounting principles. This is shown clearly by the following table:

City Fiscal Year	Amount of Tax Payment Contested	Amount Refunded	% of Claim
1946-47	$ 292,250.27	$ 132,290.00	45.3
1947-48	2,925,546.94	1,020,232.50	34.9
1948-49	3,239,580.43	764,162.50	23.6
1949-50	3,156,256.61	465,522.50	14.7
1950-51	3,270,292.22	343,745.00	10.5

My brothers are accepting the view that an accountant, viewing the tax payment for the 1950-51 fiscal year, for example, would exclude $3,270,292.22, the amount of the claim, from the tax expense accounts of that period, notwithstanding that prior experience indicates that the corporation was not likely to recover more than about 20 per cent of its claim. The accountant would also be overlooking the fact that in presenting claims based upon disputed property assessments a taxpayer will generally inflate his claim in order to secure a more strategic [fol. 107] bargaining position. I see little correspondence between such result and the fundamental aim of accrual accounting which is to match revenues with the expenses incurred in producing such revenues.

When the amount of claimed refund is thus made determinative for federal corporate tax purposes, an open invitation is extended to manipulation through self-serving appraisals. The date and amount of payment, however, appear to me to represent a fixed and definite standard, which should be here adopted in preference to the amount which the corporation unilaterally determines to contest, or to an uncertain estimate or educated guess as to the amount of refund which may be secured at some unknown future date. See *Automobile Club of Michigan v. C. I. R.*, 353 U. S. 180. Moreover, there is little reason why a taxpayer who has suffered an out-of-pocket expenditure in satisfaction of a tax assessment should be penalized by the denial of a deduction merely because he embarks upon the uncertain and often unrewarding course of contesting the amount of the assessment.

Certain Supreme Court decisions are relied on as forcing the result here reached; but at most they subscribe only to the trend as I have done above, and do not try to establish what the limits, so obviously necessary and in-

evitable, will be. Justice Roberts in *Security Flour Mills Co.* v. *C. I. R.*, 321 U. S. 281, 286, indeed goes so far as to speak disparagingly of taking cash payments, *inter alia*, "out of the annual accounting system and, for the benefit of the Government or the taxpayer, treat[ing them] on a basis which is neither a cash basis nor an accrual basis, because so to do would, in a given instance, work a supposedly more equitable result to the Government or the taxpayer." Neither in that case nor in *Dixie Pine Products Co.* v. *C. I. R.*, 320 U. S. 516, also principally relied on, is there any holding that tax liabilities already paid [fol. 108] should not be accounted for taxwise until all disputes have somehow been put at rest.[1] On the other hand, in the only actual cases presenting the precise issue, the Court of Claims in reasoned opinions, noting and considering the obstacles I have discussed above, has reached the opposite result, which Judge Sugarman below quite properly followed. See the persuasive opinion of our oft-times colleague Judge Madden in *Chestnut Securities Co.* v. *United States*, 104 Ct. Cl. 489, 62 F. Supp. 574, and of Judge Littleton in this very case in earlier years. *Consolidated Edison Co. of N. Y.* v. *United States*, 133 Ct. Cl. 376, 135 F. Supp. 881, certiorari denied 351 U. S. 909. See also 2 Mertens, Law of Federal Income Taxation §12.67, p. 106, n. 94 (1959 Cum. Supp.). Even though it has been summarily rejected by my brothers, I think Judge Madden in the *Chestnut Securities Co.* case, *supra*, 104 Ct. Cl. 489, 62 F. Supp. 574, 576, has stated the correct principle for decision here that "Accrual, from the debtor's standpoint [and the government's as well], precedes payment, and does not survive it."

I would affirm.

---

[1] In *Dixie Pine Products Co.* v. *C. I. R.*, 320 U. S. 516, a taxpayer on the accrual basis was not allowed to deduct state taxes which he was contesting and *had not paid*. No question was raised as to taxes of a previous year which had been paid. In *Security Flour Mills Co.* v. *C. I. R.*, 321 U. S. 281, a taxpayer who was making late reimbursement of a federal processing tax which had been declared invalid was not allowed to deduct these repayments as of the date of the original tax. *Lewyt Corp.* v. *C. I. R.*, 349 U. S. 237, also cited, concerns only the accruing of a federal excess profits tax in a year *earlier* than that of payment. None of these cases suggests the possibility that accrual may occur long after payment.

[fol. 109] IN THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

(File Endorsement Omitted)

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC., PLAINTIFF-APPELLANT

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLEE

JUDGMENT—May 25, 1960

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is reversed and the action be and it hereby is remanded with directions to enter summary judgment for appellant in accordance with the opinion of this court.

A. DANIEL FUSARO
Clerk

[fol. 110] • • •

[fol. 111] Clerk's Certificate to foregoing transcript omitted in printing

[fol. 112] SUPREME COURT OF THE UNITED STATES

No. 357, October Term, 1960

UNITED STATES, PETITIONER

vs.

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.

ORDER ALLOWING CERTIORARI—Filed November 14, 1960

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second Circuit is granted, and the case is transferred to the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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No. 357

Supreme Court, U.S.
FILED
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JAMES R. BROWNING, CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1960

UNITED STATES OF AMERICA, PETITIONER

v.

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

J. LEE RANKIN,
Solicitor General.
CHARLES K. RICE,
Assistant Attorney General.
GRANT W. WIPRUD,
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INDEX

	Page
Opinion below	1
Jurisdiction	1
Questions presented	2
Statutes involved	2
Statement	2
Reasons for granting the writ	4
Conclusion	6
Appendix A	7
Appendix B	24

CITATIONS

Cases:

Chestnut Securities Co. v. *United States*, 62 F. Supp. 574	4
Consolidated Edison Co. of New York v. *United States*, 135 F. Supp. 881, certiorari denied, 351 U.S. 909	4, 6
Dixie Pine Co. v. *Commissioner*, 320 U.S. 516	5
Security Mills Co. v. *Commissioner*, 321 U.S. 281	5, 6
United States v. *Gilbert Associates, Inc.*, 345 U.S. 361	5

Statutes:

Internal Revenue Code of 1939:	
Sec. 23(c) (26 U.S.C. 1946 ed., Sec. 23(c))	2, 24
Sec. 41 (26 U.S.C. 1946 ed., Sec. 41)	2, 24
Sec. 42(a) (26 U.S.C. 1946 ed., Sec. 42(a))	2, 24
Sec. 43 (26 U.S.C. 1946 ed., Sec. 43)	2, 25
Sec. 48(c) (26 U.S.C. 1946 ed., Sec. 48(c))	2, 25

In the Supreme Court of the United States

OCTOBER TERM, 1960

No. —

UNITED STATES OF AMERICA, PETITIONER

v.

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of the United States, petitions for a writ of certiorari to review the judgment of the Court of Appeals for the Second Circuit in this case.

OPINIONS BELOW

The opinion of the District Court (Appendix A, *infra*, p. 23) is unreported. The opinion of the Court of Appeals (Appendix A, *infra*, pp. 7-21) is not yet reported.

JURISDICTION

The judgment of the Court of Appeals was entered on May 25, 1960. (Appendix A, *infra*, p. 22). The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTIONS PRESENTED

1. Does a local property tax liability accrue, for the purpose of deduction by an accrual-basis taxpayer under Section 23(c) of the Internal Revenue Code of 1939, when the tax is paid under protest pursuant to an administratively final assessment, or when the ensuing refund suit is terminated by settlement in a later year?

2. If the tax accrues in the year of payment under protest, does the receipt of a partial refund in a later year, under the settlement of the refund suit, constitute income to the taxpayer in the year of settlement?

3. In any event, does the taxpayer's partial recoupment of the tax for which it has received a deduction in a prior year, now closed by the statute of limitations, constitute taxable income to it irrespective of whether the deduction was properly taken?

STATUTES INVOLVED

The statutory provisions involved, Sections 23(c), 41, 42(a), 43 and 48(c) of the Internal Revenue Code of 1939, are set forth in Appendix B, *infra* pp. 24-25.

STATEMENT

The material facts, as set forth in the opinion of the Court of Appeals (Appendix A, *infra*, pp. 7-21), may be summarized as follows:

The taxpayer is a public utility corporation which keeps its books and files its returns on a calendar-year accrual basis. The taxpayer owns considerable real estate in New York City on which it pays local property taxes, these taxes being assessed by application of the tax rates established by the City Council to final assessed valuations fixed by one City Tax Commission. In each of the years 1938-1950, with the exception of

1942 and 1943, the taxpayer contested part of the taxes so imposed; but before the end of each of these years, the taxpayer's protest was overruled by the taxing authorities, the proposed assessment became administratively final, and the full amount of such assessment was paid by the taxpayer, under protest and for the stated purpose of avoiding liens, seizures, and penalties. Such payment was not necessary in order to entitle the taxpayer to judicial review in the form of prescribed certiorari proceedings in the New York courts, although those proceedings would not stay the imposition of penalties or the foreclosure of liens.

The certiorari proceedings instituted by the taxpayer with respect to the years 1938-1940 were concluded in 1941 by settlement which fixed the taxes at a somewhat lower figure than the taxes assessed, and the difference was refunded, although the amount of refund was less than the taxpayer had sought to recover. In 1951 there was a similar settlement of the certiorari proceedings instituted by the taxpayer with respect to the years 1946-1950.

The taxpayer brought the present suit to recover an alleged overpayment of federal income taxes for 1951, contending that it should be permitted to deduct in 1951, as accruing in that year, that part of the disputed local property taxes for 1946-1950 which was recognized in the 1951 settlement as properly assessed. It argued that it was required to deduct in the years of payment under protest only that portion of the property taxes which was uncontested. The Government, on the other hand, contended that the taxpayer was required to deduct the entire amounts of the local property taxes in the years of payment under protest, and

that it was required to include in its gross income for 1951 the partial refund under the settlement reached in that year. Having paid its 1951 taxes under the Government's theory, the taxpayer brought the instant refund suit.

The District Court granted the Government's motion for summary judgment, following the decision of the Court of Claims in *Consolidated Edison Co. of New York* v. *United States*, 135 F. Supp. 881, certiorari denied, 351 U.S. 909. (Appendix A, *infra*, p. 23.) The Court of Appeals for the Second Circuit reversed, with Judge Clark dissenting. (Appendix A, *infra*, pp. 7-21.) [1]

REASONS FOR GRANTING THE WRIT

1. The decision of the Court of Appeals expressly rejects the rule adopted by the Court of Claims in *Chestnut Securities Co.* v. *United States*, 62 F. Supp. 574, and applied by that court to the taxpayer here involved and to virtually identical facts (save for the tax years in issue) in *Consolidated Edison Co. of New York* v. *United States*, 135 F. Supp. 881, certiorari denied, 351 U.S. 909. In the latter case, the Court of Claims held that the instant taxpayer was required to accrue and deduct the disputed portion of its New York real property taxes for the years 1938 and 1939 as of the time of payment under protest, and not in the later year (1941) when the ensuing refund litigation was settled.

[1] The Government also raised an affirmative defense of collateral estoppel, invoking the decision of the Court of Claims in *Consolidated Edison Co. of New York* v. *United States*, *supra*. The Government's motion for summary judgment based on this defense was denied by the District Court (162 F. Supp. 854), and that ruling was affirmed by the Court of Appeals (Appendix A, *infra*, pp. 7-21).

In the case at bar, dealing with the taxpayer's New York real property taxes for subsequent tax years, the Court of Appeals explicitly disagreed with the decision of the Court of Claims and its rationale. (Appendix A, *infra*, pp. 15-16.) The court below held that a disputed local property tax paid under protest does not accrue, for the purposes of federal income tax deduction, until the settlement or other termination of an ensuing refund suit.

The conflicting rules thus adopted by the Court of Claims and the Court of Appeals for the Second Circuit with respect to accrual and deduction of local taxes paid under protest prevent the uniform administration of the federal tax laws to a situation which, it will be evident, arises with considerable frequency throughout the United States. Since controversies over local taxes are common, the determination of the proper year for the deduction of such taxes by accrual-basis taxpayers in the computation of their federal income taxes is a matter of considerable importance both to accrual-basis taxpayers and to the federal revenues. Review is warranted so that this Court may make a definitive determination of the proper rule with respect to accrual of local taxes paid under protest in order to secure uniformity, so far as may be possible in this area. Cf. *United States* v. Gilbert Associates, Inc., 345 U.S. 361.

2. The Court of Appeals, in support of its decision, invoked cases in which this Court has held that accrual-basis taxpayers may not accrue and deduct contested local taxes until the termination of the contest. E.g., *Dixie Pine Co.* v. *Commissioner*, 320 U.S. 516, and *Security Mills Co.* v. *Commissioner*, 321 U.S 281. How-

ever, in those cases this Court was dealing with, and expressly confined its holding to, contested taxes which were not finally assessed and which remained unpaid until the conclusion of the dispute. As the Court of Claims pointed out in *Consolidated Edison Co. of New York* v. *United States, supra,* there are cogent reasons for reaching a different result where the tax has been finally assessed and paid—even though it be paid under protest—under the annualization-of-income concept which, as stressed in *Security Mills* and related cases, is fundamental to the effective and even-handed administration of the federal tax laws. As is pointed out the dissenting opinion of Judge Clark in the instant case, practical considerations also support the rule adopted by the Court of Claims.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be granted.

Respectfully submitted.

J. LEE RANKIN,
Solicitor General.

CHARLES K. RICE,
Assistant Attorney General.

GRANT W. WIPRUD,
DOUGLAS A. KAHN,
Attorneys.

AUGUST 1960.

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 298—October Term, 1959.

(Argued April 13, 1960 Decided May 25, 1960.)

Docket No. 26041

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.,
PLAINTIFF-APPELLANT,

v.

UNITED STATES OF AMERICA,
DEFENDANT-APPELLEE.

Before: LUMBARD, *Chief Judge*, and SWAN AND CLARK, *Circuit Judges*.

Appeal from the United States District Court for the Southern District of New York.

Plaintiff appeals from the order and judgment of Judge Sugarman denying plaintiff's motion for summary judgment, granting defendant's motion for sum-

mary judgment, and dismissing the complaint in an action to recover an alleged overpayment of income taxes for the year 1951. Judgment reversed.

WHITMAN, RANSOM & COULSON, *Attorneys for Plaintiff-Appellant.* James K. Polk, Harold F. Noneman, and Julius M. Jacobs of Counsel.

S. HAZARD GILLESPIE, JR., United States Attorney, *for Defendant-Appellee.* Arthur V. Savage, Assistant United States Attorney of Counsel.

SWAN, *Circuit Judge:*

Plaintiff-Appellant is a well-known public utility corporation which keeps its books and files its tax returns on an accrual and calendar year basis. It brought the present suit under 28 U. S. C. A. §1346(a) to recover an alleged large overpayment of federal income taxes for the year 1951. Defendant's answer to the complaint interposed a general denial and an affirmative defense of collateral estoppel. A motion for summary judgment based on the affirmative defense was denied by Judge Palmieri in 1958 in an opinion reported at 162 F. Supp. 854. Thereafter, upon amended pleadings and a stipulation which eliminated all factual issues, each party moved for summary judgment. The district judge, Judge Sugarman, before whom these motions were argued, denied plaintiff's motion, granted defendant's, and dismissed the complaint. This is the order appealed from.

The ultimate questions to be decided are two, namely, (1) whether, under §23(c) of the Internal Revenue

Code of 1939, a contested real estate tax liability accrued in the year the litigation was settled, or in a prior year when the contested tax was involuntarily paid under protest; and (2) whether the receipt of a partial refund of the contested and involuntarily paid tax, constituted income to the taxpayer in the year of settlement.

Before reaching the merits of these issues, it is desirable to consider defendant's contention of collateral estoppel based upon a decision of the Court of Claims which adjudicated the identical issues with respect to contested real estate taxes of earlier years. *Consolidated Edison Co. of N. Y.* v. *United States,* 133 Ct. Cl. 376, 135 F. Supp. 881, cert. den. 351 U. S. 909. The Court of Claims held that the contested taxes were deductible as a liability in the year they were paid to the City of New York, and that the amount refunded was income to the taxpayer in the year it was received from the City.[1]

On the issue of collateral estoppel both parties rely on *Commissioner* v. *Sunnen,* 333 U. S. 591, as they also did when that issue was before Judge Palmieri in 1958. He decided the issue adversely to defendant. We agree with his conclusion and are entirely satisfied with the reasoning of his opinion reported in 162 F. Supp. 854. As the *Sunnen* opinion states at page 601:

> "* * * And if the very same facts and no others are involved in the second case, a case relating to a different tax year, the prior judgment will be conclusive as to the same legal issues which appear, assuming no intervening doctrinal change. But if the relevant facts in the two cases are separable,

[1] The stipulation mentioned above preserved the Government's right to raise the question of *res judicata* or collateral estoppel on any appeal taken herein.

even though they be similar or identical, collateral estoppel does not govern the legal issues which recur in the second case. Thus the second proceeding may involve an instrument or transaction identical with, but in a form separable from, the one dealt with in the first proceeding. In that situation, a court is free in the second proceeding to make an independent examination of the legal matters at issue. It may then reach a different result or, if consistency in decision is considered just and desirable, reliance may be placed upon the ordinary rule of *stare decisis.*"

Under the New York law as to real estate taxes, the assessed valuation and the tax imposed on a given parcel of land for a given year is separate from, independent of, and unconnected with the assessed valuation and tax imposed on that parcel for any other year; and the same is true with respect to the administrative and judicial proceedings by which an aggrieved owner seeks review of the contested assessed valuation and the tax on that parcel for the given year. Hence we think it obvious that "the relevant facts" in the Court of Claims case and in the case at bar "are separable, even though they may be similar or identical," and that collateral estoppel does not control the legal issues "which recur in the second case."

To facilitate the presentation and consideration of the facts and legal issues involved, the stipulation above mentioned set forth an illustrative example which is applicable to all the years herein involved and reads as follows:

"(a) for the year 1949 plaintiff was notified, on January 25, 1949, of a tentative assessment in the amount of..... $100.

(b) plaintiff duly filed by March 15, 1949, a bona fide protest, admitting liability of.... $ 85.
(c) after hearing duly held and on or about May 25, 1949, final assessment was made in the amount of..... 100.
(d) thereafter on or about October 1, 1949, under protest and for the stated purpose of avoiding liens, seizures, levies, penalties, interest, etc., and reserving all rights, payment was made of..... 100.
(e) on October 25, 1949, certiorari proceedings were duly instituted in the New York Supreme Court admitting liability of, and denying liability in excess of..... 85.
(f) in December, 1951, the certiorari proceedings were settled, fixing the tax liability at..... 95.
and establishing an overpayment which was duly refunded, in the amount of..... $ 5."

The government claims, in terms of the example, that the taxpayer was required to deduct the entire $100 from its gross income in 1949, the year in which the money was paid, and to include in its gross income for 1951 the $5 refunded to it by the City in that year. The taxpayer's position is that it was required to deduct in 1949 only $85, the amount of real estate tax paid and uncontested and that it should be permitted to deduct in 1951 an additional $10, the portion of the disputed $15 ultimately determined to have been properly assessed. The overall effect of the taxpayer's position would be to require the payment of a greater tax than the government claims is due in the year 1949, because of the smaller deduction, and a lesser tax in the year 1951, because of the additional $10 deduction accrued then and the absence of the inclusion of the $5 refund

in gross income. Having paid its 1951 taxes under the government's theory, the taxpayer claims that it is now entitled to a refund.

The stipulation states the legal issues raised herein, in terms of the illustrative example, as follows:

> "(a) whether plaintiff is entitled to a deduction in 1951 of $10, which represents that portion of the disputed $15 which was determined in 1951 to have been properly assessed, and
>
> (b) whether there was erroneously included in plaintiff's 1951 taxable income $5, which represents that portion of the disputed $15 which was determined in 1951 to have been improperly assessed and which was refunded to plaintiff."

This illustrative example has greatly simplified the facts necessary to be stated on this appeal. It will suffice to say that appellant owns many parcels of real estate in New York City with respect to which corporate real estate taxes for each year were assessed by applying tax rates established by the City Council to final assessed valuations fixed by one City Tax Commission. In each of the years 1938 to 1950, with the exception of 1942 and 1943, the appellant contested in the manner prescribed by local law part of the taxes so imposed. The contest proceedings in respect to the years 1938-1940 were concluded in 1941 by a settlement which fixed the taxes at a somewhat lower figure than the taxes assessed, and the difference was refunded, although this was less than appellant had sought to recover.[2] A similar settlement was concluded

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[2] An illustrative example identical with the one set forth above, except for difference in dates, was stipulated by the parties and adopted by the Court of Claims in the prior suit involving the years 1938-1940.

in December 1951 of the contest proceedings instituted in respect to the years 1946-1950.

We turn now to the merits of the issues presented by the illustrative example. The sections of the 1939 Code which are involved are §§23(e), 41, 42, 43 and 48.[3] Section 23 allows a deduction from gross income to be taken for "taxes paid or accrued within the taxable year"—with exceptions not here material. Section 41 prescribes that net income shall be computed "in accordance with the method of accounting regularly employed in keeping the books of such taxpayer," unless the method employed does not clearly reflect the income. Section 42 recognizes that items of income, though normally to be included in gross income in the taxable year of receipt, may "under methods of accounting permitted under section 41" be properly accounted for as of a different period. Section 43 says that deductions and credits "shall be taken for the taxable year in which 'paid or accrued' or 'paid or incurred,' upon the basis of which the net income is computed, * * *" Section 48 directs that "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed.

In a number of cases involving the counterparts of these sections, the Supreme Court has explained that a tax liability becomes deductible under §23(e), to a taxpayer keeping its books on the accrual basis, only when all events have occurred which determine the fact and amount of the tax liability. This "all-events rule," announced in *United States* v. *Anderson*, 269 U. S. 422,

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[3] These are the same as their counterparts in the 1954 Code and in the prior Revenue Acts. Reference will be made in terms of the 1939 Code.

was very clearly restated in *Dixie Pine Co. v. Commissioner*, 320 U. S. 516, 519:

> "It has never been questioned that a taxpayer who accounts on the accrual basis may, and should, deduct from gross income a liability which really accrues in the taxable year. It has long been held that in order truly to reflect the income of a given year, all the events must occur in that year which fix the amount and the fact of the taxpayer's liability for items of indebtedness deducted though not paid; and this cannot be the case where the liability is contingent and is contested by the taxpayer. Here the taxpayer was strenuously contesting liability in the courts and, at the same time, deducting the amount of the tax, on the theory that the state's exaction constituted a fixed and certain liability. This it could not do. It must, in the circumstances, await the event of the state court litigation and might claim a deduction only for the taxable year in which its liability for the tax was finally adjudicated."

This was reaffirmed in *Security Flour Mills Co. v. Commissioner*, 321 U. S. 281, at 284. And *Lewyt Corp. v. Commissioner*, 349 U. S. 237, 242-243 states that "the concept 'accrued' embodies the annual accounting principle," and the amount of the tax accrued within the taxable year "is to be determined in accord with the normal accounting concepts relevant to the accrual basis."

Applying these cases to the issues presented by the illustrative example it is clear that the uncontested $85 of the $100 tax accrued and was deductible in 1949. Indeed, this is admitted by both parties. We think it equally clear that the contested $15 tax liability was, for

income tax purposes, a contingent liability which might or might not become a fixed liability depending upon the outcome of the State litigation. In cases of a contested item of liability, accountants usually indicate the existence of contest by showing the item as contingent, or by a footnote. Ten dollars of the contested $15 became a fixed liability when the litigation terminated in 1951, and became deductible in that year. The remaining $5 never became a liability of the taxpayer. Nor was the receipt of that sum from the City in 1951 income of the taxpayer; it was the realization of an asset of contingent value purchased by the taxpayer when it paid the City the $15 it was contesting. A payment may constitute a capital expenditure, an exchange of assets, a prepaid expense, a deposit, or a current expense. When the exact nature of the payment is not immediately ascertainable because it depends on some future event, such as the outcome of litigation, its treatment for income tax purposes must await that event. Thus in *Doyle* v. *Commissioner*, 2 Cir. 110 F. 2d 157, this court held that the income tax treatment of forfeited payments received under a contract to sell real estate was to be determined by, and was to be reflected in the year of the subsequent events, rather than the year in which the payments were received; see also *Bressner Radio, Inc.* v. *Commissioner*, 2 Cir. 267 F. 2d 520.

It is true that the Supreme Court cases above cited did not involve a taxpayer who paid a contested tax during the pendency of the contest. That question was presented in the *Consolidated Edison* case in the Court of Claims, *supra*, and that Court followed its earlier decision in *Chestnut Securities Co.* v. *United States*, 104 Ct. Cl. 489, 62 F. Supp. 574 which held that "Accrual, from the debtor's standpoint, precedes payment and does not survive it." With due respect we disagree

with this view. Indeed, the findings of fact with respect to applicable accounting principles which the Court of Claims made in the *Consolidated Edison* case are inconsistent with such decision.[4] The principles of accrual accounting set forth in those findings are correct. A decision supporting them will prevent a taxpayer from taking the inconsistent positions of contesting a liability and at the same time claiming a deduction for it. The position which the government urges seems to us inconsistent with the general policy of obtaining the largest amount of tax revenue at the earliest possible date. In the usual run of cases, the government's insistence that the taxpayer take his deduction in the year of paying under protest a contested liability will result in the receipt of less tax revenue in that year. For this reason (among others) in the *Chestnut Securities* case, the government took a position opposite to that here urged. The government lost that case. In following the Court of Claims without discussing the principles involved, we think Judge Sugarman fell into error. In conformity with those principles summary judgment should have been entered for the plaintiff-appellant.

It is suggested in criticism of our decision that it leaves open to a taxpayer opportunities for manipula-

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[4] See Findings Nos. 35 to 38 inclusive, particularly 38 which reads as follows: "Under accrual accounting, when payment is made with respect to a liability which is denied in whole or in part, the accounting principle as to charges against income would be the same as if payment had not been made; such payment would not affect the treatment of any accruals. This principle applies equally to the payment of taxes. The payment of admitted or estimated ultimate liability constitutes the payment of a current charge or expense of operations and the balance of that payment represents an amount estimated to be ultimately recovered and is chargeable to a suspense, deferred debit, or other receivable account. The latter item represents an asset—a deposit which is expected to be recovered."

tion through self-serving appraisals. Such opportunities are no greater when payment has been made under protest to prevent the attachment of liens or seizure, than when payment has not been made, as in the *Dixie Pine* case. The problem of determining whether the contest is a bona fide one is present in either situation. The criticism, we think, is really directed against the *Dixie Pine* line of decisions.

Accordingly the judgment is reversed and the cause remanded with directions to enter summary judgment for plaintiff-appellant pursuant to paragraphs 12 and 13 of the stipulation of the parties.

CLARK, *Circuit Judge* (dissenting):

Apparently accountants and at least some tax lawyers agree that the Commissioner has not been appropriately hospitable to the precepts of accrual accounting and applaud tentative judicial steps toward accepting such precepts. See, e.g., Behren, *Prepaid Income —Accounting Concepts and the Tax Law*, 15 Tax L. Rev. 343 (1960), discussing *Bressner Radio, Inc.* v. *C. I. R.*, 2 Cir., 267 F. 2d 520. For my part I would not disagree and think that within limits the trend to follow accounting ideas is desirable as bringing tax and business practices mutually into line. But I do feel it must stop short of delivering control of the revenue to the accountants. For accounting is not an exact science; and corporate balance sheets must deal with many fluid items, representing of course much factual information, but also a certain amount of prophecy, of hope, and of sheer argumentation. Because of this, because also the accountant does owe the duty of loyalty to his client, the result will naturally reflect the needs and desires of the client more than the appropriate

demands of the tax collector, who not only must collect all the revenue due, but must hold the balance fairly and without discrimination among taxpayers. And the present holding, which goes beyond anything yet in the books, seems to me to exceed proper bounds in committing final adjudication as to the revenue to corporate accountants.

Consider the actual decision herein. It is that deductions for local tax liability are to be made, not when the liability is due *and* paid, but when some years later and after dispute the parties (not including the representative of the federal revenue) get together and adjust their difference. The opinion suggests no limitation of time or otherwise on the operation of the principle thus broadly announced; and upon reflection I can see none of any actual operative effect. It would seem that a taxpayer, by asserting a dispute as to a liability for taxes paid, may postpone the use of such payment as an income tax deduction practically indefinitely until it finds it expedient to settle the dispute with or without receipt of a refund. I presume the dispute must be honestly asserted with perhaps some indicated possibility of success. But these are such minimal requirements as to the large tax liabilities of great corporations as to be meaningless in practice. Obviously a local tax dispute can be prolonged for years; and extrinsic factors such as a corporate reorganization might prolong it yet further. Moreover, I do not see how the principle can be limited only to tax payments; it would seem applicable to other disputed payments generally. Thus ascertainment of the corporate income is substantially taken out of the hands of the revenue authorities; discrimination between taxpayers is accomplished on the basis of the astuteness of the accountants employed; and the sound rule of *annual* federal tax accounting—perhaps the cornerstone of federal

revenue collecting—is repudiated in a vitally important detail.

Moreover, an examination of the history of plaintiff's real estate tax controversies with the City of New York for the fiscal years here involved indicates that the result reached by the majority does not even accord with generally accepted accounting principles. This is shown clearly by the following table:

City Fiscal Year	Amount of Tax Payment Contested	Amount Refunded	% of Claim
1946–47	$ 292,250.27	$ 132,290.00	45.3
1947–48	2,925,546.94	1,020,232.50	34.9
1948–49	3,239,580.43	764,162.50	23.6
1949–50	3,156,256.61	465,522.50	14.7
1950–51	3,270,292.22	343,745.00	10.5

My brothers are accepting the view that an accountant, viewing the tax payment for the 1950-51 fiscal year, for example, would exclude $3,270,292.22, the amount of the claim, from the tax expense accounts of that period, notwithstanding that prior experience indicates that the corporation was not likely to recover more than about 20 per cent of its claim. The accountant would also be overlooking the fact that in presenting claims based upon disputed property assessments a taxpayer will generally inflate his claim in order to secure a more strategic bargaining position. I see little correspondence between such result and the fundamental aim of accrual accounting which is to match revenues with the expenses incurred in producing such revenues.

When the amount of claimed refund is thus made determinative for federal corporate tax purposes, an open invitation is extended to manipulation through self-serving appraisals. The date and amount of payment, however, appear to me to represent a fixed and definite standard, which should be here adopted in preference to the amount which the corporation unilaterally determines to contest, or to an uncertain estimate

or educated guess as to the amount of refund which may be secured at some unknown future date. See *Automobile Club of Michigan* v. *C. I. R.*, 353 U. S. 180. Moreover, there is little reason why a taxpayer who has suffered an out-of-pocket expenditure in satisfaction of a tax assessment should be penalized by the denial of a deduction merely because he embarks upon the uncertain and often unrewarding course of contesting the amount of the assessment.

Certain Supreme Court decisions are relied on as forcing the result here reached; but at most they subscribe only to the trend as I have done above, and do not try to establish what the limits, so obviously necessary and inevitable, will be. Justice Roberts in *Security Flour Mills Co.* v. *C. I. R.*, 321 U. S. 281, 286, indeed goes so far as to speak disparagingly of taking cash payments, *inter alia*, "out of the annual accounting system and, for the benefit of the Government or the taxpayer, treat[ing them] on a basis which is neither a cash basis nor an accrual basis, because so to do would, in a given instance, work a supposedly more equitable result to the Government or the taxpayer." Neither in that case nor in *Dixie Pine Products Co.* v. *C. I. R.*, 320 U. S. 516, also principally relied on, is there any holding that tax liabilities already paid should not be accounted for taxwise until all disputes have somehow been put at rest.[1] On the other hand, in the only actual

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[1] In *Dixie Pine Products Co.* v. *C. I. R.*, 320 U. S. 516, a taxpayer on the accrual basis was not allowed to deduct state taxes which he was contesting and *had not paid*. No question was raised as to taxes of a previous year which had been paid. In *Security Flour Mills Co.* v. *C. I. R.*, 321 U. S. 281, a taxpayer who was making late reimbursement of a federal processing tax which had been declared invalid was not allowed to deduct these repayments as of the date of the original tax. *Lewyt Corp.* v. *C. I. R.*, 349 U. S. 237, also cited, concerns only the accruing of a federal excess profits tax in a year *earlier* than that of payment. None of these cases suggests the possibility that accrual may occur long after payment.

cases presenting the precise issue, the Court of Claims in reasoned opinions, noting and considering the obstacles I have discussed above, has reached the opposite result, which Judge Sugarman below quite properly followed. See the persuasive opinion of our oft-times colleague Judge Madden in *Chestnut Securities Co.* v. *United States,* 104 Ct. Cl. 489, 62 F. Supp. 574, and of Judge Littleton in this very case in earlier years. *Consolidated Edison Co. of N. Y.* v. *United States,* 133 Ct. Cl. 376, 135 F. Supp. 881, certiorari denied 351 U. S. 909. See also 2 Mertens, Law of Federal Income Taxation §12.67, p. 106, n. 94 (1959 Cum. Supp.). Even though it has been summarily rejected by my brothers, I think Judge Madden in the *Chestnut Securities Co.* case, *supra,* 104 Ct. Cl. 489, 62 F. Supp. 574, 576, has stated the correct principle for decision here that "Accrual, from the debtor's standpoint [and the government's as well], precedes payment, and does not survive it."

I would affirm.

JUDGMENT

U. S. District Court. Filed Jun. 13, 1960. S.D. N. Y.

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the twenty-fifth day of May, one thousand nine hundred and sixty.

Present: HON. J. EDWARD LUMBARD, Chief Judge, HON. THOMAS W. SWAN, HON. CHARLES E. CLARK, Circuit Judges.

Civ. 110-191

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC., PLAINTIFF-APPELLANT

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLEE

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is reversed and the action be and it hereby is remanded with directions to enter summary judgment for appellant in accordance with the opinion of this court.

A. DANIEL FUSARO,
Clerk.

A true copy:

—— ——, Clerk,
By Elsie M. Eiler, Deputy Clerk.

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

DECISION, ORDER AND JUDGMENT

October 23, 1959.

The facts presented by this litigation are set forth in Judge Palmieri's decision in *Consolidated Edison Company of New York* v. *United States*, 162 F. Supp. 854 (S. D. N. Y. 1958).

The identical issues presented by this litigation, except that they dealt with earlier years, are set forth in Judge Littleton's decision in *Consolidated Edison Company of New York* v. *United States*, 135 F. Supp. 881 (Ct. Cls.) 1955, *cert. denied* 351 U.S. 909. No gainful purpose can be served by repeating the facts or issues.

Assuming that *Standard Oil Company* v. *United States*, 51 AFTR 1688, 56-2 U. S. T. C. Para. 10051 (N. D. Ohio 1956), is not distinguishable on its facts from *Consolidated Edison Company of New York* v. *United States, supra*, I am disposed to follow what was said in the latter case. Accordingly, the plaintiff's motion for summary judgment is denied and the defendant's motion for summary judgment, dismissing the complaint, is granted.

It is so ordered. No further order is necessary.

SIDNEY SUGARMAN,
United States District Judge.

Judgment entered October 23, 1959.

Herbert A. Charlson, Clerk.

APPENDIX B

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(c) [as amended by Sec. 202(a), Revenue Act of 1941, c. 412, 55 Stat. 687] *Taxes Generally.*—

(1) *Allowance in general.*—Taxes paid or accrued within the taxable year. * * * [with exceptions not material here].

* * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

(26 U.S.C. 1946 ed., Sec. 41.)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED—

(a) *General rule.*

The amount of all items of gross income shall be included in the gross income for the taxable year in

which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

(26 U.S.C. 1946 ed., Sec. 42.)

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

(26 U.S.C. 1946 ed., Sec. 43.)

SEC. 48. DEFINITIONS.

When used in this chapter—

* * * * *

(c) *"Paid or incurred," "paid or accrued".* The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

(26 U.S.C. 1946 ed., Sec. 48.)

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No. 357

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1960

THE UNITED STATES OF AMERICA,
Petitioner,

v.

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

STATEMENT ON BEHALF OF RESPONDENT

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No. 357

IN THE

Supreme Court of the United States

OCTOBER TERM, 1960

UNITED STATES OF AMERICA,

Petitioner,

vs.

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

STATEMENT ON BEHALF OF RESPONDENT

Opinions Below

The opinion of the United States Court of Appeals for the Second Circuit (Appendix A, Petition pp. 7-21) is reported in 279 F. 2d 152. The opinion of the District Court (Appendix A, Petition p. 23) is unreported.

Jurisdiction

The judgment of the Court of Appeals was entered on May 25, 1960. The jurisdiction of this Court is invoked under 28 U. S. C. 1254.

Questions Presented

The questions presented involve the deductibility under federal income tax law of contested real estate taxes of the City of New York and the taxability of certain refunds in real estate taxes of the City of New York received by the respondent.

While conducting *bona fide* contests regarding its liability for New York City real estate taxes in excess of the amount it admitted to be correct, respondent (an accrual basis taxpayer) in each of the years 1946-1950, involuntarily paid the contested amounts, pending the outcome of the contest proceedings, in order to avoid seizure of, and the foreclosure of the liens upon, the realty involved. The real estate tax liens could not be suspended, stayed, or in any way removed, either by the contest or otherwise, except by payment.

In 1951 the contest proceedings were settled whereby part of the contested tax liability was determined to be correct, and the balance, which was determined to be incorrect, was refunded to respondent (par. 6 of stipulation, pp. 6a-8a of Joint Appendix).

The specific questions presented are as stipulated (par. 3 of Stipulation, p. 5a of Joint Appendix):

1. Whether under Section 23(c) of the Internal Revenue Code of 1939, the contested real estate tax liability accrues in the year the litigation is settled (1951), or prior thereto, in the year the disputed tax is involuntarily paid (1946-1950) pending the outcome of the contest proceedings; and

2. Whether the amount of contested tax liability determined by the settlement to have been incorrect which was refunded constitutes taxable income in the year of settlement (1951).

Statutes Involved

The statutory provisions involved are Sections 23(c), 41, 42(a), 43, and 48(c) of the Internal Revenue Code of 1939[1] (Appendix B, Petition pp. 24-25).

Statement On Behalf Of Respondent

In Petitioner's statement of the questions presented (Petition p. 2), no indication is given that question 1 as phrased in the Petition involves the accrual of a tax liability which is *denied* and *contested*, or that the unadmitted tax was *involuntarily paid pending the outcome of the contest proceedings.*

The statement of question 2 in the Petition assumes the answer to question 1 to be in Petitioner's favor.

The statement of question 3 in the Petition raises a non existent issue. Paragraph 12 of the amended answer (Joint Appendix, p. 91a) requests that, should Respondent prevail herein, the earlier years be reaudited consistent with the final decision herein;—a remedy that is granted by Sections 1311-1315 of the Internal Revenue Code of 1954, whereunder the Commissioner of Internal Revenue will have one year after the judgment for Respondent becomes final within which to reaudit Respondent's returns for 1946-1950 and assess deficiencies based upon any double deductions taken with respect to the disputed taxes as provided in said Sections 1311-1315. Moreover, this so-called defense was eliminated by paragraph 3 of the stipulation of the parties, *supra.*

The decision of the court below is based on the decisions of this Court in *United States* v. *Anderson,* 269 U. S. 422; *Dixie Pine Products Co.* v. *Commissioner,* 320 U. S. 516;

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[1] Similar provisions are contained in the 1954 Code.

United States v. *Olympic Radio & Television, Inc.*, 349 U. S. 232; and *Lewyt Corporation* v. *Commissioner*, 349 U. S. 237. However, the Court below disagreed with interpretations of these decisions which had been made by the Court of Claims in *Chestnut Securities Co.* v. *United States*, 104 C. Cls. 489, 62 F. Supp. 574, and *Consolidated Edison Co. of New York, Inc.* v. *United States*, 133 C. Cls. 376, 135 F. Supp. 881. Thus the decision of the United States Court of Appeals for the Second Circuit in the instant case is in conflict with the earlier decisions of the Court of Claims.

The Respondent recognizes the fact that the question of when a deduction may be taken of unadmitted and contested taxes which are involuntarily paid pending the outcome of the contest proceedings is of importance both to taxpayers and to the government and that in the interest of uniform administration of the tax laws the present conflict thereon should be resolved by this Court.

Conclusion

By reason of the foregoing, Respondent, while believing that the decision of the Court below is correct, nevertheless joins in the request of Petitioner that a writ of certiorari be issued. It submits, however, that the questions which this Court should consider are stated at page 2, *supra*.

Respectfully submitted,

JAMES K. POLK,
Counsel for Respondent.

Of Counsel:
RICHARD J. SMITH,
HAROLD F. NONEMAN,
JULIUS M. JACOBS.

Dated: September 19, 1960.

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No. 357

In the Supreme Court of the United States

OCTOBER TERM, 1960

UNITED STATES, PETITIONER

v.

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

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INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statutes involved	2
Statement	4
Summary of argument	8
Argument	12
I. When the taxpayer discharged its liability for the contested property taxes by payment under protest, the liability accrued for federal income tax purposes	14
A. The applicable principles of tax accounting	14
B. Under the annual accounting system, a liability accrues no later than the date on which payment is made	17
C. Taxpayer's remittances to the City of New York were true payments which fully discharged its obligations to the City	26
II. Taxpayer, having recovered a portion of its payments in settlement of its suit for refund, must include that amount in its gross income for the year of settlement	30
Conclusion	32

CITATIONS

Cases:

Baltimore & O. R. Co. v. *Magruder*, 77 F. Supp. 156, affirmed, 174 F. 2d 896, certiorari denied, 338 U.S. 828	20
Bartlett v. *Delaney*, 173 F. 2d 535, certiorari denied, 338 U.S. 817	31
Bazley v. *Commissioner*, 331 U.S. 737	14

Cases—Continued Page

Brown v. *Helvering*, 291 U.S. 193 ..... 14, 15, 16
Burnet v. *Sanford & Brooks Co.*, 282 U.S. 359 ..... 15, 22
Chestnut Securities Co. v. *United States*, 62 F. Supp. 574 ..... 10, 13, 19, 20, 23
Consolidated Edison Co. of New York v. *United States*, 135 F. Supp. 881, certiorari denied, 351 U.S. 909 ..... 7, 9, 13, 20, 30
Dixie Pine Co. v. *Commissioner*, 320 U.S. 516 ..... 10, 16, 17, 18, 21
Guaranty Trust Co. v. *Commissioner*, 303 U.S. 493 15
Harrison v. *Schaffner*, 312 U.S. 579 24
Healy v. *Commissioner*, 345 U.S. 278 24
Heiner v. *Mellon*, 304 U.S. 271 15
Lehigh Valley Railroad Co. v. *Commissioner*, 12 T.C. 977 ..... 19, 20, 30
Lewyt Corp. v. *Commissioner*, 215 F. 2d 518 ..... 28, 29
Lewyt Corp. v. *Commissioner*, 349 U.S. 237 ..... 17, 28
Lucas v. *American Code Co.*, 280 U.S. 445 ..... 14, 16
North American Oil v. *Burnet*, 286 U.S. 417 24
People ex rel. Ottley Estate Corp. v. *Lilly*, 302 N.Y. 278, 97 N.E. 2d 903 29
Rothensies v. *Electric Storage Battery Co.*, 329 U.S. 296 31
Rosenman v. *United States*, 323 U.S. 658 ..... 27, 28, 29
Security Mills Co. v. *Commissioner*, 321 U.S. 281 ..... 10, 14, 15, 16, 17, 18, 19, 21, 22
Standard Oil Co. v. *United States* (N.D. Ohio), decided October 30, 1956 20
Union Trust Co. v. *Commissioner*, 111 F. 2d 60, certiorari denied, 311 U.S. 658 31
United States v. *Anderson*, 269 U.S. 422 ..... 14, 15
United States v. *Lewis*, 340 U.S. 590 ..... 23, 24, 30
United States v. *Olympic Radio & Television*, 349 U.S. 232 14
Weiss v. *Wiener*, 279 U.S. 333 14
Western Cartridge Co. v. *Commissioner*, 11 T.C. 246 19

Statute: Page

Internal Revenue Code of 1939:
Sec. 22(b). (26 U.S.C. 1952 ed., Sec. 22(b)) .. 31
Sec. 23(c) (26 U.S.C. 1952 ed., Sec. 23(c)) . 2, 14
Sec. 41 (26 U.S.C. 1952 ed., Sec. 41) 2, 14
Sec. 42 (26 U.S.C. 1952 ed., Sec. 42) 3, 14
Sec. 43 (26 U.S.C. 1952 ed., Sec. 43) 3, 14
Sec. 48 (26 U.S.C. 1952 ed., Sec. 48) 4, 14

Miscellaneous:

1949-2 Cum. Bull. 2 30
G.C.M. 25298, 1947-2 Cum. Bull. 39 20
59 McKinney's Consolidated Laws of New York Annotated (1954 ed.), Tax Law, Sec. 296 29
Mim. 6444, 1949-2 Cum. Bull. 11 ..... 20, 30
Recommendations to Congress by the American Institute of Accountants Regarding Divergencies Between Rules of Tax Accounting and Generally Accepted Accounting Principles, 97 Journal of Accountancy 93 (1954) 14

In the Supreme Court of the United States

OCTOBER TERM, 1960

No. 357

UNITED STATES, PETITIONER

v.

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the District Court (R. 3) is unreported. The opinion of the Court of Appeals (R. 39-50) is reported at 279 F. 2d 152.

JURISDICTION

The judgment of the Court of Appeals was entered on May 25, 1960. (R. 51.) The petition for a writ of certiorari was filed on August 23, 1960, and was granted on November 14, 1960. 364 U.S. 890. (R.

52.) The jurisdiction of this Court rests upon 28 U.S.C., Section 1254(1).

QUESTIONS PRESENTED

1. Whether, for federal income tax purposes, a contested property tax liability was deductible by the taxpayer (which is on the accrual basis of accounting) in the taxable year in which the liability was discharged by payment made under protest, or in a subsequent taxable year in which a suit for refund of a portion of the payment was settled.

2. Whether the portion repaid to the taxpayer in settlement of its refund suit is includible in its gross income in the year of settlement.

STATUTES INVOLVED

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * *

(c) [as amended by Sec. 202(a), Revenue Act of 1941, c. 412, 55 Stat. 687] *Taxes Generally.*—

(1) *Allowance in general.*—Taxes paid or accrued within the taxable year. * * * [with exceptions not material here].

* * * *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period

(fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

(26 U.S.C. 1952 ed., Sec. 41.)

SEC. 42 [as amended by Sec. 114, Revenue Act of 1941, *supra*]. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED—

(a) *General rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 42.)

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to

clearly reflect the income the deductions or credits should be taken as of a different period. * * *

(26 U.S.C. 1952 ed., Sec. 43.)

SEC. 48. DEFINITIONS.

When used in this chapter—

(a) *Taxable year.*

"Taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under this Part. * * *

* * * *

(c) *"Paid or incurred," "paid or accrued."* The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

* * * *

(26 U.S.C. 1952 ed., Sec. 48)

STATEMENT

The taxpayer, a public utility corporation, keeps its books and files its returns on a calendar year-accrual basis. (R. 40.) It owns considerable real estate in New York City on which it pays local property taxes. The taxes are assessed by applying the tax rates established by the City Council to the final assessed valuations fixed by the City Tax Commission. (R. 43.) In each of the years 1938-1950, with the exception of 1942 and 1943, the taxpayer contested part of the taxes so imposed; but before the end of each of those years, the taxpayer's protest was over-

ruled by the taxing authorities, the proposed assessment became administratively final, and the full amount of the taxes was paid by the taxpayer under protest and for the stated purpose of avoiding liens, seizures, and penalties. (R. 5-6, 42-43.) Although payment was not a requisite to judicial review in the form of prescribed certiorari proceedings in the New York courts, it was necessary to stay the imposition of penalties and the foreclosure of liens. (R. 18.)

The New York certiorari proceedings instituted by the taxpayer with respect to the years 1938-1940 were concluded in 1941 by a settlement which fixed the taxes at a somewhat lower figure than the taxes assessed. The difference (which was substantially less than the recovery sought by the taxpayer) was refunded. In 1951, there was a similar settlement of certiorari proceedings instituted by the taxpayer with respect to the years 1946-1950. (R. 43.) Only the latter years and the settlement of the claims made in relation to those years are involved in this action.

To facilitate consideration of the questions presented, the following example was stipulated by the parties (and used by the court below) as applicable to all of the years here involved (R. 10, 41-42):

(a) for the year 1949 plaintiff was notified, on January 25, 1949, of a tentative assessment in the amount of	$100.
(b) plaintiff duly filed by March 15, 1949, a bona fide protest, admitting liability of	85.
and petitioning for an administrative reduction of said tentative assessment by	15.
(c) after hearing duly held and on or about May 25, 1949, final assessment was made in the amount of	100.

(d) thereafter on or about October 1, 1949, under protest and for the stated purpose of avoiding liens, seizures, levies, penalties, interest, etc., and reserving all rights, payment was made of 100.

(e) on October 25, 1949, certiorari proceedings were duly instituted in the New York Supreme Court admitting liability of, and denying liability in excess of 85.

(f) in December, 1951, the certiorari proceedings were settled, fixing the tax liability at 95. and establishing an overpayment which was duly refunded, in the amount of 5.

In its federal income tax returns for the taxable years 1946-1950, the taxpayer claimed as a deduction, each year, the full amount of the property tax paid under protest in that year, and the claimed deductions were allowed by the Commissioner. (R. 22.) In its return for the taxable year 1951, the year in which it received, pursuant to the settlement, a refund of a portion of the amount previously paid and deducted, it included the amount refunded in gross income. Thereafter, the taxpayer brought the present suit to recover an alleged overpayment of federal income tax for 1951, contending (1) that it should have deducted, in the years 1946-1950, only the portion of the property tax which it did not contest, (2) that it should be permitted to deduct, in 1951, the portion of the contested amount which was recognized in the 1951 settlement as having been properly assessed, and (3) that it should not have included in its 1951 income the refunded portion of the payment. (R. 13-15.) The Government opposed taxpayer's claim of overpayment of its 1951 federal income tax, on the ground

that taxpayer had properly deducted the entire amount of the property tax in the years of payment and had properly included in its gross income for 1951 the amount refunded under the settlement reached in that year.[1] (R. 42-43.)

The District Court granted the Government's motion for summary judgment, following the decision of the Court of Claims in *Consolidated Edison Co. of New York* v. *United States*, 135 F. Supp. 881, certiorari denied, 351 U.S. 909. (R. 3.) The Court of Appeals for the Second Circuit reversed, Judge Clark dissenting. (R. 39-50.)[2]

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[1] In terms of the stipulated example, taxpayer, in its 1949 return, claimed, and was allowed, a deduction of $100 (the full amount of its payment); and in its 1951 return included in gross income $5 (the portion refunded). It now contends that, in 1949, it should have deducted only $85 (the uncontested portion of the payment), that it should be permitted to deduct in 1951 an additional $10 (the additional amount recognized in the settlement as properly assessed), and that it should have excluded from its 1951 income the $5 refunded under the settlement. The Government contends that taxpayer properly deducted the entire $100 payment in 1949, and properly included the $5 refund in its 1951 income.

[2] The Government also raised an affirmative defense of collateral estoppel, invoking the decision of the Court of Claims in *Consolidated Edison Co. of New York* v. *United States, supra*. The Government's motion for summary judgment based on this defense was denied by the District Court (162 F. Supp. 854), and that ruling was affirmed by the Court of Appeals. (R. 40-47.) The point is not presented by the petition filed in this Court.

SUMMARY OF ARGUMENT

This case turns on the application of settled tax accounting principles to a taxpayer which files its returns on the accrual basis, pays a contested liability under protest and, in a taxable year subsequent to payment, recovers a portion of the payment in settlement of a refund suit.

I

It is settled by numerous decisions of this Court that, for federal income tax purposes, gross income and items of deduction must be accounted for on an annual, rather than on a transactional, basis. This is so irrespective of whether the taxpayer employs the cash or the accrual method of accounting. As applied to taxpayers using the accrual method, the annual accounting rule requires that an item of gross income be reported in the taxable year in which the right to receive it becomes fixed; conversely, an item of deduction is to be taken in the taxable year in which the liability to pay it becomes fixed, both in fact and in amount. It is also settled, as a corollary to these principles, that an *unpaid contested* liability does not become fixed, and hence is not deductible by an accrual-basis taxpayer, unless and until the contest is terminated adversely to the taxpayer.

The narrow issue here is whether an accrual-basis taxpayer which *pays* a local property tax assessment under protest, and then sues to recover part of the payment, may postpone the year of accrual beyond

the year of payment.[3] The Court of Claims has twice held that the deduction may be taken only in the year of payment, albeit the payment was made unwillingly and suit for its recovery was brought; one of those cases involved the same taxpayer and the same set of facts as the instant case, but different taxable years. *Consolidated Edison Co. of New York v. United States*, 135 F. Supp. 881, certiorari denied, 351 U.S. 909. The Tax Court has similarly so held. We urge that these decisions represent the correct view.

Payment by a debtor to his creditor of an asserted liability operates to discharge the liability, even though the payment is made under protest and the debtor seeks (immediately or subsequently) to recover it in whole or in part. And, once the asserted liability has been satisfied, there is no warrant for assuming that it has not yet accrued for tax deduction purposes. Nothing in the decided cases (other than the majority opinion below) supports taxpayer's contention that one who has discharged a contested liability by payment may defer its deduction to a year subsequent to that of payment merely because the payment was made under protest and a refund is claimed. On the contrary, in holding that an *unpaid* contested liability is not deductible by an accrual-basis taxpayer prior to the year in which the contest

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[3] Although a number of payments of city tax assessments for each of several years are involved, for convenience the assessments and payments are sometimes referred to in the singular. See also the stipulated illustrative example (R. 10), and footnote 5, *infra*.

is terminated, this Court indicated that the result would have been different had the contested liability been *paid*. *Security Mills Co.* v. *Commissioner*, 321 U.S. 281; *Dixie Pine Co.* v. *Commissioner*, 320 U.S. 516. The rationale of the decisions which preclude accrual of an *unpaid* contested liability—the uncertainty that the disputed obligation would ever be paid—calls for accrual where, as here, a contested tax liability has been finally assessed and paid; the only contingency which then remains relates to the taxpayer's right to the claimed refund.

Whether, under commercial accounting practice, it would be customary to accrue the payment in question does not determine whether accrual was proper for *tax accounting* purposes. As a matter of fact, however, taxpayer's returns did treat the amount paid as an expense incurred and deductible in the year of payment.

Had taxpayer employed the cash method of accounting, all other facts being the same, it admittedly would have been required to deduct the payment in question in the year of payment, notwithstanding the institution of a suit for refund. Since the accrual method of accounting contemplates that deductions are ordinarily to be taken in a year *prior* to that of actual payment, *i. e.*, in the year when the liability to pay becomes definite, *a fortiori* an accrual-basis taxpayer should not be able to postpone deduction beyond the year of actual payment. As the Court of Claims has said (*Chestnut Securities Co.* v. *United States*, 62 F. Supp. 574, 576), "Accrual, from the debtor's standpoint, precedes payment, and does not

survive it". Again, had the payment in question been made without protest, *e. g.*, under a misapprehension or mistake, it clearly would have been deductible in the year of payment, despite the institution of a refund suit and the probability that the payment would be recovered. And, viewing the matter from the standpoint of a payee (whether he be on the cash or accrual basis), he plainly receives income when a disputed claim is paid, even though the payor plans to seek restitution.

Practical considerations strongly support the view we urge. Certainly, it is desirable that objective and readily ascertainable criteria determine the proper year of accrual as well as other taxable events. Payment of an asserted liability, whether voluntarily made (with or without protest) or involuntarily made through seizure of a debtor's assets, is a definitive event—an actual expenditure which leaves the debtor out-of-pocket. To permit a taxpayer to postpone a deduction, when that course offers the possibility of tax advantage, by making a claim for refund of a paid obligation and keeping that claim alive until he chooses to terminate it, is to invite the "astute accountant" (see the dissenting opinion of Judge Clark, R. 48) to manipulate income tax consequences in disregard of the annual accounting principle.

Since, under our analysis, the critical event is the fact of payment, we emphasize that there is no question in this case that the remittances made by taxpayer to the City of New York were true payments—not, for example, the mere posting of security—and that they fully extinguished the obligation in satisfaction of which they were tendered.

II

If the liability in question was accruable and deductible in the year of payment, as taxpayer treated it in its returns and as the Government contends, then the portion refunded to the taxpayer in a subsequent year, in settlement of its refund suit, is includible in its gross income in the year of settlement. This result follows from application of the annual accounting rule and the corollary tax-benefit doctrine. Taxpayer conceded the point in the court below, and presumably does not dispute it here.

ARGUMENT

This case involves the application of established principles of federal income tax accounting to a taxpayer which (1) files its returns on the accrual basis; (2) contested a local property tax liability asserted against it; (3) pursuant to a final administrative assessment of the tax, discharged the liability by making payment under protest; and (4) in a subsequent taxable year, in settlement of a refund suit, recovered a portion of the payment.

In its returns, the taxpayer deducted the full amount of the payment in the taxable year in which it was made (1949), and included the portion refunded in its gross income for the year of recovery (1951). This approach, we believe, was correct. Taxpayer now contends, however, that it should have deducted, in the year of payment, only that portion of the liability which it did not contest; that it should have deducted, in the year of settlement and refund,

an additional portion, representing the additional amount recognized by the settlement as having been properly assessed; and that it should not have included the refunded portion in its 1951 income. It is the Government's position, based upon the decision of the Court of Claims in *Consolidated Edison Co. of New York* v. *United States, supra*,[4] that the taxpayer's original returns were correct, and that its present claim of overpayment of 1951 federal income tax was properly rejected by the Commissioner and the District Court.[5]

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[4] The Court of Claims in *Consolidated Edison Co.* followed its prior decision in *Chestnut Securities Co.* v. *United States, supra.*

[5] In terms of the stipulated illustration (R. 10, 42), the controversy as to the proper year of deduction is confined to the $15 portion of the $100 tax assessed against and paid by taxpayer, that being the only portion contested by it. The parties are in agreement that the uncontested portion ($85) is deductible only in the year of payment (1949).

As to the $15 portion, it is the Government's position that all of it was likewise deductible in the year of payment, and that the $5 subsequently repaid on settlement of the refund suit was includible in taxpayer's gross income in the year of settlement (1951). On the other hand, it is taxpayer's position that no part of the $15 paid was deductible in the year of payment, that the $10 difference between that amount and the $5 later refunded was deductible in the year of settlement, and that the $5 refunded should have been excluded from its gross income.

I

When the Taxpayer Discharged Its Liability for the Contested Property Taxes by Payment Under Protest, the Liability Accrued for Federal Income Tax Purposes

A. *The applicable principles of tax accounting.*

Taxpayer keeps its books and files its federal income tax returns on the accrual basis. (R. 40.) Consequently, under the applicable federal tax statutes,[6] it may deduct its local property taxes only in the year in which those taxes accrue as a liability. *Security Mills Co.* v. *Commissioner*, 321 U.S. 281; *United States* v. *Anderson*, 269 U.S. 422. Taxpayer, having elected to use the accrual method, must apply it consistently, and neither taxpayer nor the Government may cause an item to be reported in a year other than that in which it accrues. *United States* v. *Olympic Radio & Television*, 349 U.S. 232; *United States* v. *Anderson, supra; Security Mills Co.* v. *Commissioner, supra*, pp. 286-287.

The date of accrual of an item for federal tax purposes does not necessarily coincide with that of its accrual under commercial accounting practice (which, incidentally, is not invariably uniform). *Lucas* v. *American Code Co.*, 280 U.S. 445, 452; *Brown* v. *Helvering*, 291 U.S. 193, 202; *Bazley* v. *Commissioner*, 331 U.S. 737, 741.[7] See Recommendations to Con-

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[6] Sections 23(c), 41, 42, 43 and 48 of the Internal Revenue Code of 1939, *supra*, pp.

[7] As this Court stated in *Weiss* v. *Wiener*, 279 U.S. 333, 335:

> The income tax laws do not profess to embody perfect

gress by the American Institute of Accountants Regarding Divergencies Between Rules of Tax Accounting and Generally Accepted Accounting Principles, 97 Journal of Accountancy 93 (1954). Taxable income must be computed on an annual accounting basis; each "taxable year" is treated as a separate unit, and all items of gross income and deduction are reflected in terms of their posture at the close of the year, irrespective of subsequent events or the final outcome of a particular transaction. *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 359, 363-365; *Heiner* v. *Mellon*, 304 U.S. 271, 275; *Guaranty Trust Co.* v. *Commissioner*, 303 U.S. 493; *Brown* v. *Helvering*, *supra*; *Security Mills Co.* v. *Commissioner*, *supra*. The rationale of the system was stated by the Court in *Security Mills* as follows (321 U.S., at 286):

> "It is the essence of any system of taxation that it should produce revenue ascertainable, and payable to the government, at regular intervals. Only by such a system is it practicable to produce a regular flow of income and apply methods of accounting, assessment, and collection capable of practical operation."

The touchstone for determining when items accrue as deductions under the annual accounting system is the "all events" test established by this Court more than thirty-five years ago in *United States* v. *Anderson*, 269 U.S. 422. In that case, the Court held that

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economic theory. They ignore some things that either a theorist or a business man would take into account in determining the pecuniary condition of the taxpayer.

* * *

a munitions tax assessed and paid in 1917 accrued as a tax deduction in the *prior* year in which the taxpayer's liability for the tax became definite. The Court stated (269 U.S. at 440-441):

> Only a word need be said with reference to the contention that the tax upon munitions manufactured and sold in 1916 did not accrue until 1917. In a technical legal sense it may be argued that a tax does not accrue until it has been assessed and become due; but it is also true that in advance of the assessment of a tax, *all the events may occur which fix the amount of the tax and determine the liability of the taxpayer to pay it.* * * * (Emphasis added.)

The "all events" test has been reaffirmed by this Court on numerous occasions, and is now a fundamental principle of tax accounting. *E.g.*, *Lucas* v. *American Code Co.*, 280 U.S. 445; *Brown* v. *Helvering*, 291 U.S. 193; *Dixie Pine Co.* v. *Commissioner*, 320 U.S. 516, 519; *Security Mills Co.* v. *Commissioner*, 321 U.S. 281, 284. In the Court's words (*Security Mills* case, pp. 286-287):

> This legal principle has often been stated and applied. The uniform result has been denial both to the Government and to taxpayer of the privilege of allocating income or outgo to a year other than the year of actual receipt or payment, *or, applying the accrual basis, the year in which the right to receive, or the obligation to pay, has become final and definite in amount.*
>
> But the petitioner urges that § 43 has altered the rule so that a hybrid system, partly annual and partly transactional, may, within adminis-

> trative discretion, be substituted for that of annual accounting periods. * * * The very section on which petitioner relies, however, reiterates the adherence of Congress to the system of annual periods of computation. (Emphasis added.)

In *Lewyt Corp.* v. *Commissioner*, 349 U.S. 237, the Court once more restated these principles, observing, with respect to the accrual of a tax liability, that (p. 242) "the concept 'accrued' embodies the annual accounting principle."

B. *Under the annual accounting system, a liability accrues no later than the date on which payment is made.*

In *Dixie Pine Co.* v. *Commissioner, supra*, the Court added a refinement to the "all events" test. In that case, the taxpayer had accrued as a federal tax deduction the amount of a state gasoline tax which it had not paid and was contesting. The Court held that the taxpayer could not deduct the unpaid item prior to the termination of the contest.

Again, in *Security Mills Co.* v. *Commissioner, supra*, the Court held that a contested *unpaid* liability did not accrue as a deduction until the contest was settled. In that case, the Court disallowed deductions taken by the taxpayer for processing taxes which it had not paid [8] and was contesting. It stated (321 U.S. at 284):

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[8] A large portion of the item in dispute in *Security Mills* had been paid by the taxpayer into a depository. Such a deposit does not constitute a "payment". See Point IC, *infra*, pp. 26-30. While the court did not expressly discuss that question, it treated the item as unpaid. 321 U.S. at 284.

> It is settled by many decisions that a taxpayer may not accrue an expense the amount of which is unsettled or the liability for which is contingent, and this principle is fully applicable to a tax, liability for which the taxpayer denies, *and payment whereof he is contesting.* Here the petitioner, in figuring its costs and its sales price to consumers, added the amount of the processing tax, but it collected its purchase price as such and designated no part of it as representing the tax. The petitioner received the purchase price as such. Its tax liability, if any, to the United States, did not differ from other debts. Since it denied liability for, *and failed to pay,* the tax during the taxable year 1935, it was not in a position in its tax accounting to treat the Government's claim as an accrued liability. As it admittedly received the money in question in 1935 and could not deduct from gross income an accrued liability to offset it, the receipt, it would seem, must constitute income for that year. (Emphasis added.)

The decisions in *Security Mills* and *Dixie Pine* are rooted in the "all events" principle. Of course, when the taxpayer is contesting its liability to pay an item, its liability is contingent and cannot be deemed to have accrued. However, when the taxpayer pays the item and thereby discharges its liability, the expense has been incurred and there is no longer any contingency which would prevent its accrual. The liability has "vested", even though there is a possibility —one not susceptible of prediction or measurement— of "defeasance." Significantly, in both *Dixie Pine* and *Security Mills*, the Court stressed that the lia-

bility there involved had not been paid. In *Security Mills* particularly, the Court implied that a contested liability accrues when paid; it said (321 U.S. at 284) that the taxpayer could not accrue the tax there involved because it had denied liability for "and failed to pay" it.

Shortly after the decision in *Security Mills*, the Court of Claims held that a contested tax liability accrued on the date of payment even though payment was made under protest and the contest was continued after that date. *Chestnut Securities Co.* v. *United States*, 62 F. Supp. 574 (C. Cls.). The court stated (p. 576):

> One is not entitled to accrue a debt or other liability which is asserted against him but which he disputes and litigates, until the litigation is concluded. But if a liability is asserted against him and he pays it, though under protest, and though he promptly began litigation to get the money back, the status of the liability is that it has been discharged by payment. It is hardly conceivable that a liability asserted against him, which he has discharged by payment, has not yet "accrued" within the meaning of the tax laws and the terminology of accounting. Accrual, from the debtor's standpoint, precedes payment, and does not survive it.

The Tax Court has reached the same conclusion. *Lehigh Valley Railroad Co.* v. *Commissioner*, 12 T.C. 977;[9] *Western Cartridge Co.* v. *Commissioner*, 11 T.C.

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[9] In the *Lehigh* case, the taxpayer paid, each year, the amount of a state railroad property tax that it admitted to be due, and contested the balance. However, during the

246, 267-268. See, also, *Baltimore & O. R. Co.* v. *Magruder*, 77 F. Supp. 156, 169-170 (Md.), affirmed, 174 F. 2d 896 (C.A. 4th), certiorari denied, 338 U.S. 828. But see *Standard Oil Co.* v. *United States* (N.D. Ohio), decided October 30, 1956 (51 A.F.T.R. 1688).

Although the Government's position in the *Chestnut Securities* litigation was not the position which we here urge, after the decision in *Chestnut Securities* the Government reconsidered the matter and announced that it would follow the ruling of the Court of Claims. G.C.M. 25298, 1947-2 Cum. Bull. 39; Mim. 6444, 1949-2 Cum. Bull. 11. Thereafter, the Government successfully litigated the present question with this same taxpayer. *Consolidated Edison Co. of New York* v. *United States*, 135 F. Supp. 881 (C. Cls.), certiorari denied, 351 U.S. 909. That case was identical to this one, except that it involved different taxable years. The Court of Claims reaffirmed its decision in *Chestnut Securities*, holding that contested local property taxes accrued

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litigation, the taxpayer was required by court order to make additional payments in order to keep its total payment at a prescribed percentage of the tax originally imposed. The Tax Court held that the unpaid taxes did not accrue until the litigation was settled. However, it further held that the contested taxes involuntarily paid by taxpayer during the litigation accrued and were deductible in the years when paid. The court said (12 T.C., pp. 999-1000):

> We hold, further, that amounts of the unpaid and contested taxes which were paid from time to time during the progress of the litigation accrued and were deductible from gross income in the respective years when paid.

when paid under protest, rather than in the later year when the contest was settled.

The court below, reversing the District Court and disagreeing with the Court of Claims and the Tax Court, held that the New York taxes paid by taxpayer were not to be accrued and deducted in the years paid. Its decision, we believe, conflicts with the annual accounting rule and related accrual principles enunciated by this Court. When a taxpayer contests an asserted liability, his obligation to pay is contingent upon the success or failure of the contest and, therefore, all of the events determining his liability do not occur until the contest is concluded. *Dixie Pine Co.* v. *United States*, *supra*; *Security Mills Co.* v. *Commissioner*, *supra*. However, when the taxpayer makes payment during the course of the contest, even though under protest, this contingency disappears since no additional events are necessary to insure satisfaction of the contested liability.[10] The expense has been incurred.

Taxpayer made the payments in question for the avowed purpose of satisfying the tax assessments made by the City against it, so as to remove tax liens from its property and stop the running of interest. (R. 6.) In other words, taxpayer intended to, and did, extinguish its liability. To be sure, taxpayer made its payments under protest and continued its contest with the City, seeking a partial refund. However, after the payment was made, the taxpayer's liability to make payment was satisfied and no longer

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[10] See Point IC, *infra*, pp. 26-30.

contingent; it was the payee City which might become obligated at some future date to make repayment to taxpayer. Future events could not erase the fact that taxpayer's liability had been extinguished by payment, but could affect only taxpayer's right to receive income by way of a refund.

Taxpayer contends that, although payment may have extinguished its liability, the net amount of tax it would ultimately pay, in case it was successful in its refund suit, remained contingent until the suit was settled. Thus, taxpayer urges a "transactional" treatment of income and deductions, in violation of the prescribed annual accounting system. *Security Mills Co.* v. *Commissioner*, *supra*, at 287; *Burnet* v. *Sanford & Brooks Co.*, *supra*, at 365. It is immaterial that there might have been a partial refund in a year subsequent to that of payment, so that from a transactional viewpoint taxpayer's net expenditure (after offsetting the later year's refund) might turn out to be less than that incurred in the year of payment. Under the annual accounting rule, each taxable year is a separate unit for purposes of computing taxable income, *i.e.*, gross income less deductions, regardless of the taxpayer's ultimate gain or loss from a given transaction.

Had taxpayer filed its returns on the cash basis, it unquestionably would have been required to deduct the payments in question in the years of payment, notwithstanding the fact that it immediately brought suit for refund and might later recover all or part of the payments. Since, under the accrual method, income and deductible items are generally reported

in a taxable year prior to that of actual receipt or payment, *i.e.*, in the year when the right to receive or the liability to pay becomes fixed, it would seem to follow, *a fortiori*, that a taxpayer filing its returns on the accrual basis may not postpone a deduction item beyond the year of actual payment. "Accrual, from the debtor's standpoint, preeedes payment, and does not survive it." *Chestnut Securities Co.* v. *United States*, 62 F. Supp. 574, 576 (C. Cls.).

Indeed, even as to a taxpayer reporting on the accrual basis, the payments in question would clearly have been deductible in the years of payment—notwithstanding the suit for refund and the possibility of recovery—had payment been made under a mistake of fact or law. That the taxpayer here made the payment under protest, instead of mistakenly, is of no consequence for income tax accounting purposes: The critical fact is that its liability to pay was discharged by payment. Under the annual accounting rule the liability accrued and was deductible in the year of payment, despite the pendency of a refund claim, as of the close of that year. Cf. *United States* v. *Lewis*, 340 U.S. 590.

In this case, as it happens, the payments made by taxpayer were to the City of New York, an entity not subject to federal income tax. It is nonetheless relevant to consider what the situation would be, from the payee's standpoint, if the payee were also liable for income taxes. The fundamental rule that the tax be computed on the basis of annual accounting periods requires that money *received* under a claim of right and without restriction as to its use be re-

ported as income in the year received, even though the taxpayer-payee may, in a later year, be required to restore the payment. *North American Oil* v. *Burnet*, 286 U.S. 417; *United States* v. *Lewis*, 340 U.S. 590; *Healy* v. *Commissioner*, 345 U.S. 278. This, we submit, supports the correlative proposition which we urge—that the one who *pays* the money in discharge of an asserted liability may claim its deduction only in the year of payment, albeit, in a later year, he may recover the payment.

There are practical considerations which support our view. "Taxation is a practical matter", *Harrison* v. *Schaffner*, 312 U.S. 579, 582, and the orderly administration of the revenue laws requires that taxable events be readily determinable both as to fact and as to time. If there is a contest as to the existence of a liability, if the contest remains unresolved, and if no payment has been made by the alleged debtor to the alleged creditor, the matter is so contingent that there is no ready means at hand for ascertaining the facts of tax significance. The legal conclusion that, in these circumstances, the alleged debtor has not accrued a liability accords with the practicalities. If, on the other hand, a payment has been made in discharge of an obligation, an objective, measurable and definitive occurrence has taken place. This is so even though the payor says that he was overcharged or overassessed, and that he plans to seek restitution of some portion of his payment. There is thus a solid, practical basis for saying that a discharged obligation is invariably an accrued obligation.

There is a further practical consideration. Taxpayers, at least in the vast majority of instances, are constrained by various circumstances to meet their obligations as they fall due. Thus, it cannot be assumed, in the generality of cases, that a businessman who believes that it might be advantageous, from the tax standpoint, to postpone a substantial deduction to a future tax year, would feel free to contrive a contest and to withhold payment, over a substantial period of time, from a creditor. Arrayed against the possible tax advantage would be numerous countervailing considerations—loss of standing in the business community, deterioration of relations with the creditor, impairment of credit generally, the possibility of costly litigation, liability for the payment of interest. There are, however, far less substantial obstacles to calculated tax evasion if one can prevent accrual of an item by making payment and then filing, and keeping on file so long as desired, a paper claim for refund. We disavow any suggestion that the respondent in this case has filed its claims against the City of New York in bad faith, or that it has calculatingly inflated those claims,[11] or that it has failed to prosecute them with diligence. Our point is that taxpayer's theory invites the possibility of abuse. As Judge Clark, in his dissenting opinion, stated the point (R. 48):

> * * * It would seem [under the majority's view] that a taxpayer, by asserting a dispute

[11] Judge Clark does correctly note (R. 48-49) that the aggregate of the claims made during the years 1946-1951 was several times the total recovery.

as to a liability for taxes paid, may postpone the use of such payment as an income tax deduction practically indefinitely until it finds it expedient to settle the dispute with or without receipt of a refund. I presume the dispute must be honestly asserted with perhaps some indicated possibility of success. But these are such minimal requirements as to the large tax liabilities of great corporations as to be meaningless in practice. Obviously a local tax dispute can be prolonged for years; and extrinsic factors such as a corporate reorganization might prolong it yet further. Moreover, I do not see how the principle can be limited only to tax payments; it would seem applicable to other disputed payments generally. Thus ascertainment of the corporate income is substantially taken out of the hands of the revenue authorities; discrimination between taxpayers is accomplished on the basis of the astuteness of the accountants employed; and the sound rule of *annual* federal tax accounting—perhaps the cornerstone of federal revenue collecting—is repudiated in a vitally important detail.

C. ***Taxpayer's remittances to the City of New York were true payments which fully discharged its obligations to the City.***

The taxpayer's obligation to pay the contested property taxes arose when the City assessed and billed the taxes.[12] The obligation was discharged and extinguished when taxpayer paid the assessment under protest; indeed, taxpayer voluntarily made the pay-

[12] Joint Appendix in the court below, p. 58a (on file with this Court, but not reprinted).

ment under protest in order to prevent involuntary payment of the amount assessed (plus interest and penalties) through seizure of its assets. (R. 6.) The obligation having been satisfied by payment, it manifestly did not survive payment, not even as a contingent obligation. All that taxpayer had then was a contingent right to receive repayment, by reason of its ensuing suit for refund. And, as argued above, application of the annual accounting rule required accrual of the obligation in the year it was extinguished by payment.

The court below did not address itself to the critical question whether the payments under protest served to discharge taxpayer's liability for the taxes assessed against it. The majority reasoned that the payments did not require accrual of liability in the year of payment simply because of the contingency that the payments might be refunded to taxpayer in a later year. The decision below thus rests essentially upon the erroneous premise that payment of an assessed but contested tax does not suffice to extinguish the taxpayer's liability to pay it.

In *Rosenman* v. *United States*, 323 U.S. 658, this Court considered the meaning of the term "payment" for purposes of applying the statute of limitations on refund claims. The taxpayer there made remittances under protest to the Commissioner for the purpose of avoiding liens and penalties; this occurred prior to assessment of the underlying tax. The Commissioner placed the sums in a suspense account, and after audit determined a deficiency greater than the amount deposited. The Commissioner then assessed

the deficiency, and applied the deposited funds in partial payment. The taxpayer thereupon paid the balance, and sued for refund. In holding that the taxpayer's remittances were not "payments" on which the statute of limitations had run, the court stressed that the deficiency had not yet been assessed on the date that the deposits were made and that consequently the deposits did not discharge a liability. They were merely payments "in escrow" having the same effect as a security bond, and bearing no interest. The reasoning which impelled the Court in *Rosenman* to hold that payment had not there been made calls for the opposite conclusion here.

The question of what constitutes a payment for purposes of accrual of a tax liability was also presented in *Lewyt Corp.* v. *Commissioner*, 215 F. 2d 518 (C.A. 2d), affirmed on other issues, 349 U.S. 237. In holding that the taxpayer's remittance, which had been placed in a suspense account by the Commissioner, was not a payment, the Second Circuit stated (p. 522):

> * * * the Court [in *Rosenman*] under the facts of that case held that no "tax payment" occurred until there had been an assessment followed by its satisfaction in part out of moneys already deposited with the Collector and in part by additional amounts paid by the taxpayer in response to such assessment, since it was only at that point that interest began to run against the Government on any amount in excess of that ultimately found due as the tax. While we do not read Rosenman to foreclose treating as a tax payment any remittance made prior to assess-

ment, we do think that it supports the view that a remittance that does not *satisfy* an asserted tax liability should not be treated as the "payment" of a tax. *Satisfaction may, as in* Rosenman, *follow from payment of a tax assessed, for such a payment extinguishes the asserted liability, even though the taxpayer is left with an independent claim for refund which survives the discharge of the assessment.* * * * (Emphasis added.)

The payments here involved plainly constituted "payments" in discharge of an asserted tax liability within the rationale of *Rosenman* and *Lewyt*. The taxes had already been assessed by the City; and the payments were made for the avowed purpose of stopping the running of interest, avoiding imposition of penalties, and preventing foreclosure of the City's tax lien. Taxpayer was left with only a claim for refund, which might or might not materialize in a later year. That taxpayer's payments operated to discharge its liability is confirmed by the fact that it was entitled to interest on any amount refunded, from the date of payment.[13] 59 McKinney's Consolidated Laws of New York Annotated (1954 ed.), Tax Law, Sec. 296. *People ex rel. Ottley Estate Corp.* v. *Lilly*, 302 N.Y. 278, 97 N.E. 2d 903.

It is true that taxpayer's payments were "involuntary" in the sense that they were made under threat of economic sanctions. Indeed, virtually all payments of contested tax liabilities are motivated

[13] Taxpayer's refund suit was settled for a lump sum (R. 7), which presumably included an amount attributable to interest.

by similar considerations. However, the test of whether a remittance is a payment does not depend upon the underlying motivation of the payor, but upon whether the debt was thereby discharged. See *Lehigh Valley Railroad Co.* v. *Commissioner*, 12 T.C. 977.[14]

II

Taxpayer, Having Recovered a Portion of Its Payments in Settlement of Its Suit for Refund, Must Include that Amount in Its Gross Income for the Year of Settlement

If, as we contend (Point I, *supra*), the taxpayer properly deducted the entire amount of the payments in question in the years of payment (1946-1950), it follows that the portion refunded in settlement of its refund suit is includible in its gross income for the year of settlement (1951). This result is required not only by the annual accounting rule (cf. *United*

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[14] While the payments here involved were made under protest, they were not prerequisite to certiorari proceedings in the New York courts for review of the validity of the assessment. (R. 6, 18.) Even if prepayment were a condition precedent to judicial review of the assessment, we submit that the result ought be no different since such payment would likewise have discharged the taxpayer's liability. Mim. 6444, 1949-2 Cum. Bull. 11, which indicates otherwise, was issued prior to the decision of the Court of Claims in *Consolidated Edison Co. of New York* v. *United States*, *supra*, since followed by the Commissioner. The Commissioner has acquiesced in the Tax Court's decision in the *Lehigh* case, *supra*, holding that an involuntary payment pursuant to court order of a contested state tax required accrual and deduction of the tax in the year of payment. 1949-2 Cum. Bull. 2.

States v. *Lewis*, 340 U.S. 590), but by the corollary tax-benefit rule codified in Section 22(b)(12) of the Internal Revenue Code of 1939. *Rothensies* v. *Electric Storage Battery Co.*, 329 U.S. 296, 298; *Bartlett* v. *Delaney*, 173 F. 2d 535 (C.A. 1st), certiorari denied, 338 U.S. 817; *Union Trust Co.* v. *Commissioner*, 111 F. 2d 60 (C.A. 7th), certiorari denied, 311 U.S. 658. In its reply brief in the court below (p. 20), taxpayer conceded that, if the Government's position with respect to the deduction issue is correct, the Government's position on the refund issue is also correct.[15] As to this proposition, therefore, we presume that the parties are in agreement.

CONCLUSION

Taxpayer's payments of the contested taxes were properly deducted in its returns for the respective years of payment (1946-1950), and the amount refunded to it in 1951 was properly reported as income

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[15] Taxpayer also concedes that if its contentions are upheld it should not be permitted to have the benefit of a double deduction of any part of the payments—once in the year of payment, and again in the year the refund suit was settled. Statement on Behalf of Respondent, filed in reply to the petition for certiorari (p. 3).

in its return for that year. Accordingly, the judgment of the Court of Appeals should be reversed.

Respectfully submitted,

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FEBRUARY, 1961

☆ U. S. GOVERNMENT PRINTING OFFICE: 1961 903393 859

MAR 9 1961
JAMES R. BROWNING, Clerk

No. 357

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1960

UNITED STATES OF AMERICA,

Petitioner,

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

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INDEX

	PAGE
OPINIONS BELOW	1
JURISDICTION	1
QUESTIONS PRESENTED	2
STATUTES INVOLVED	2, 53-54
STATEMENT	2
SUMMARY OF ARGUMENT	10
ARGUMENT	13
I. Under established principles of income tax accrual, the amount of a contested tax liability is contingent and non deductible under Section 23(c)(1) until the litigation is ended; an involuntary, compulsory payment thereof pending the outcome of the litigation does not, as a matter of law, accrue the amount as a deduction at the date of payment	13
Income Tax Accrual is a "Technical Concept"—"All Events Rule" of *Anderson*	14
"Contested Tax Liability Test" of *Dixie Pine*—Another Facet of the All Events Rule	15
Payment of a Contingent Liability Does Not Accrue Such Contingent Liability as a Deduction	18
The "Annual Accounting Principle" of *Security Mills*	26

PAGE

II. Respondent's position follows the congressional intent that, absent countervailing administrative or revenue protection considerations, income tax accrual should coincide with recognized principles of accrual accounting 31

The Congressional Intent That Income Tax Accrual Coincide With Recognized Principles of Accrual Accounting 32

Respondent's Position in the Present Case Accords with the Recognized Accounting Principles That Payment, *per se*, Has No Effect Upon Accrual 34

Administrative Considerations Support, Rather Than Militate Against, Congruency in the Present Case, of the Statutory Concept of Accrual With Recognized Accounting Principles 34

The Commissioner's Administration of the Question Presented Herein Has Been Vacillating and Inconsistent. His Reliance Upon *G. C. M. 25298* Is a Bootstrap Attempt and is Contrary to Its Subsequent Modification in *Mim. 6444* 37

III. The authorities upon which the Government relies are contrary to the principles of accrual established by this Court; and do not support the Government's contentions 39

The *Chestnut Securities* Doctrine—"Accrual Does Not Survive Payment" 39

The "Otherwise Accruable" Doctrine Enunciated by the Court of Claims in the *Consolidated Edison* case 42

PAGE

The Court of Claims Decisions Are Contrary to the Decisions of Other Courts on This Question and on Related Matters .. 43

The Other Cases Cited by the Government Fail to Support Its Claim in the Present Case 46

IV. The right to a refund of part of a contested and involuntarily paid tax, as determined by a later settlement of the contest, does not constitute income in the year of settlement 51

V. The decision and judgment of the court below should be affirmed 52

CITATIONS

CASES:

Baltimore & O. R. Co. v. *Magruder*, 77 F. Supp. 156 (D. C. Md.-1948) 41, 47, 50

Bates Motor Transport Lines, Inc., 17 T. C. 151 (1951 affd. 200 F. 2d 20, (C. A. 7-1952) 46

Ralph A. Boatman, 32 T. C. 1188 (1959) 10, 19

Bressner Radio, Inc. v. *Commissioner*, 267 F. 2d 520 (C. A. 2-1959) 11, 27, 33

Brown v. *Helvering*, 291 U. S. 193 (1934) 14

E. L. Bruce Co., 19 B. T. A. 777 (1930) 15

Bull v. *United States*, 295 U. S. 247 (1935) 34

Burnet v. *Sanford & Brooks Co.*, 282 U. S. 359 (1931) 11, 27

Cartex Mills, Inc., 42 B. T. A. 894 (1940) 15

Chestnut Securities Co. v. *United States*, 104 C. Cls. 489, 262 F. Supp. 574 (1945) 12, 24, 37, 39, 40, 41, 42, 43, 44, 46, 48, 49, 50

PAGE

Chicot County Drainage District v. *Baxter State Bank*, 308 U. S. 371 (1940) 15
Commissioner v. *Boylston Market Association*, 131 F. 2d 966 (C. A. 1-1942) 19
Commissioner v. *Central United National Bank*, 99 F. 2d 568 (C. A. 6-1938) 15
Commissioner v. *Dwyer*, 203 F. 2d 522 (C. A. 2-1953) 13, 52
Commissioner v. *Fifth Ave. Coach Lines*, 281 F. 2d 556 (C. A. 2-1960) 30
Commissioner v. *Gillette Motor Transport, Inc.*, 364 U. S. 130 (1960) 19
Consolidated Edison Co. of New York v. *United States*, 133 Ct. Cls. 376, 135 F. Supp. 881 (1955) cert. den. 351 U. S. 909 (1956) 5, 6, 10, 12, 34, 38, 39, 41, 42, 43, 44, 55
Consolidated Edison Company of New York v. *United States*, 162 F. Supp. 854 (D. C. S. D. N. Y.-1958) 5
Consolidated Edison Co. v. *United States*, 279 F. 2d 152 (C. A. 2-1960) 1, 10, 11, 12, 19, 36
R. D. Cravens, 30 T. C. 903 (1958) 19
Cravens v. *Commissioner*, 272 F. 2d 895 (C. A. 10-1959) 19

Davies' Estate v. *Commissioner*, 126 F. 2d 294 (C. A. 6-1942) 15
The Dill Co., 33 T. C. 196 (app. pending, C. A. 3) .. 10, 19
Dixie Pine Products Co. v. *Commissioner*, 320 U. S. 516, 64 S. Ct. 364, 88 L. Ed. 270 (1944) 10, 11, 14, 16, 17, 18, 20, 22, 26, 27, 30, 31, 34, 35, 40, 43, 44, 49, 50
Dixie Pine Products Co. v. *Commissioner*, 134 F. 2d 273 (C. A. 5-1943) 15
J. A. Dougherty's Sons, Inc. v. *Commissioner*, 121 F. 2d 700 (C. A. 3-1941) 15
Doyle v. *Commissioner*, 110 F. 2d 157 (C. A. 2-1940) 10, 19, 20
Richard M. Drachman, 23 T. C. 558 (1954) 19

PAGE

E. B. Elliott Co., 45 B. T. A. 82 (1941) 15
Elliott v. *Swartwout*, 10 Pet. 137 (U. S.-1836) 26
John Ernst, 32 T C. 181 (1959) 19

Federal Machine & Welder Co., 11 T. C. 952 (1948) 19
Flora v. *United States*, 362 U. S. 145 (1960) 22

The Great Island Holding Corporation et al. v. *Commissioner*, 5 T. C. 150 (1945), acq. C. B. 1945, 3 3

Helvering v. *Mitchell*, 303 U. S. 391, 399 (1938) .. 22

Kings County Savings Institution v. *Blair*, 116 U. S. 200 (1886) 26

Lehigh Valley Railroad Co., 12 T. C. 977 (1949) .. 16, 38, 39, 46, 47, 49
Lewyt Corporation v. *Commissioner*, 349 U. S. 237 (1955) 11, 14, 18, 35
Lewyt Corporation v. *Commissioner*, 215 F. 2d 518 (C. A. 2-1954) 20, 22, 23, 24, 25
Lowe Bros. Co. v. *United States*, 304 U. S. 302 (1938) 26
Lucas v. *American Code Co.*, 280 U. S. 445 (1930) 15, 49

McEachern v. *Rose*, 302 U. S. 56 (1937) 13, 52
McGoldrick v. *Berwind-White Coal Mining Co.*, 309 U. S. 33 (1940) 40

Nat Friedman & Sons, Inc. v. *New York*, 262 N. Y. 665, 188 N. E. 112 (1933) 21
New York Central Railroad Co. v. *Limburg*, 261 App. Div. 562 (2d Dept.-1941), app. dism. 286 N. Y. 605, 35 N. E. 2d 942 (1941) 21
New York Trust Co v. *Eisner*, 256 U. S. 345 (1921) 27
Norton v. *Shelby County*, 118 U. S. 425 (1886) 15
North American Van Lines v. *United States*, 169 F. Supp. 252 (C. Cl.-1959) 42

PAGE

Olympic Radio & Television, Inc. v. *United States*, 124 C. Cls. 33, 110 F. Supp. 600 (1953) 41, 42, 50

People ex rel. Staten Island Rapid Transit Co. v. *Taylor*, 247 App. Div. 405, 287 N. Y. S. 456 (1st Dept.-1936) 21

People ex rel. Wessel Nickel & Gross v. *Craig*, 236 N. Y. 100, 140 N. E. 209 (1934) 4

Philadelphia v. *Collector*, 5 Wall. 720 (U. S.-1886) 26

Rock Island A. & L. R. R. Co. v. *United States*, 254 U. S. 141 (1920) 26

Rosenman v. *United States*, 323 U. S. 658 (1945) 20, 22, 23, 24, 25

Rothensies v. *Electric Storage Battery Co.*, 329 U. S. 296 (1946) 51

Schlude v. *Commissioner*, 283 F. 2d 234 (C. A. 8-1960) pet. for cert. filed Jan. 4, 1961 ..... 12, 44, 45

Security Flour Mills Co. v. *Commissioner*, 321 U. S. 281 (1944) 11, 14, 18, 27, 28, 29, 30, 31, 35, 40, 44, 49

Security Flour Mills Co., 45 B. T. A. 671 (1941) .. 29

Security Flour Mills Co. v. *Commissioner*, 135 F. 2d 165 (C. A. 10-1943) 29

Sikora Realty Corp. v. *New York*, 262 N. Y. 312, 186 N. E. 796 (1933), rearg. den. 262 N. Y. 636, 188 N. E. 99 (1933) 21

Sohio Corp. v. *Commissioner*, 163 F. 2d 590 (C. A. D. C.-1947) 45, 46

Spring City Foundry Co. v. *Commissioner*, 292 U. S. 182 (1934) 14

Stanard-Tilton Milling Co., 3 T. C. 1026, (1944) (2d Issue) 30

Standard Oil Co. of Ohio v. *United States*, 51 AFTR 1688, 56-2 USTC (CCH) Par. 10051 (D. C. Ohio-1956) 12, 43

Streckfus Steamers, Inc., 19 T. C. 1 (1952) (Acq. 1953-1 C. B. 6) 13, 35, 52

Swift v. *City of Poughkeepsie*, 37 N. Y. 511 (1868) 21

PAGE

United States v. *Anderson*, 269 U. S. 422 (1926) .. 10, 11, 14, 17, 18, 20, 21, 32, 34, 35, 44, 50

United States v. *Olympic Radio & Television, Inc.*, 349 U. S. 232 (1955) 12, 14, 18, 41, 42, 50

United States Trust Co. v. *Mayor, etc. of New York*, 144 N. Y. 488, 39 N. E. 383 (1895) 21

Unitex Industries, Inc., 30 T. C. 468 (1958) 19

Veenstra & DeHahn Coal Co., 11 T. C. 964 (1948) 19

Waldheim Realty & Inv. Co. v. *Commissioner*, 245 F. 2d 823 (C. A. 8-1957) 19

Welch v. *DeBlois*, 94 F. 2d 842 (C. A. 1-1938) 19

Western Cartridge Co., 11 T. C. 246 (1948) 46, 49

Wisconsin v. *J. C. Penney Co.*, 311 U. S. 435 (1940) 40

Young Women's Christian Assn. v. *New York*, 217 App. Div. 406 (1st Dept. 1926), Affd. 244 N. Y. 562, 157 N. E. 858 (1927) 21

STATUTES:

Internal Revenue Code of 1939 (26 U. S. C. 1952 ed.):

Sec. 22(b)(12) 35, 51
Sec. 23(a) 28, 29
Sec. 23(c) 14, 16, 17, 18, 20, 26, 27, 28, 31, 39, 50, 51
Sec. 23(c)(1) 2, 10, 13, 41, 53
Sec. 41 ..... 2, 29, 32, 33, 53
Sec. 42(a) 2, 32, 53
Sec. 43 ..... 2, 28, 29, 32, 54
Sec. 48(c) 2, 32, 54
Sec. 122(d)(6) 24
Sec. 271(a)(1)(B) 25
Sec. 272 23

PAGE

Internal Revenue Code of 1954 (26 U. S. C. 1954 ed.):

Sec. 452 32
Sec. 462 32
Sec. 1311-1315 ..... 9, 13, 52

United States Judicial Code (28 U. S. C. 1954 ed.):

Sec. 1254(1) 1
Sec. 1346 26

MISCELLANEOUS:

G. C. M. 9575, X-1 C. B. 381 35
G. C. M. 25298, 1947-2 C. B 39 ..... 3, 9, 11, 37, 38
Mim. 6444, C. B. 1949-2, 11 ..... 11, 37, 38
Rev. Rul. 57-105, C. B. 1957-1, 193 3
Rev. Rul. 59-184, 1959-1, C. B. 65 19
I. T. 3491, C. B. 1941-2, 177 ..... 8, 9
I. T. 3865, C. B. 1947-2, 144 9
H. Rep. No. 1337 on H. R. 8300, 83rd Cong., 2d Sess. (1954), pp. 159, 162-163 32
Sen. Rep. No. 1622 on H. R. 8300, 83rd Cong., 2d Sess. (1954), pp. 301-303, 305-307 32
H. and Sen. Rep. on H. R. 4725, 84th Cong., 1st Sess. C. B. 1955-2, 852, at pp. 853-855 and 859-861, respectively 33
5 Williston on Contracts, Rev. Ed. 1937 Sec. 1619A, pp. 4524-28 4
"Time for Accrual of Income and Expenses" by William M. Emery, New York University 17th Annual Institute on Federal Taxation, pp. 183-186 (1949) 32

No. 357

IN THE

Supreme Court of the United States

OCTOBER TERM, 1960

UNITED STATES OF AMERICA,

Petitioner,

v.

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

Opinions Below

The opinion of the District Court (R. 3) is unreported. The opinion of the Court of Appeals (R. 39-50) is reported at 279 F. 2d 152.

Jurisdiction

The judgment of the Court of Appeals was entered on May 25, 1960 (R. 51). The petition for a writ of certiorari was filed on August 23, 1960, and was granted on November 14, 1960. 364 U. S. 890 (R. 52). The jurisdiction of this Court rests upon 28 U. S. C. Sec. 1254(1).

Questions Presented

1. Whether under Section 23(c)(1) of the Internal Revenue Code of 1939, a contested real estate tax liability accrues in the year the litigation is settled (1951), or prior thereto, in the year the disputed tax is involuntarily paid (1946-1950) pending the outcome of the proceedings to reduce the tax liability.

2. Whether the right to a refund of part of the contested and involuntarily paid tax, as determined by the settlement terminating the contest, constitutes taxable income in the year of settlement (1951).

Statutes Involved

The pertinent provisions of Sections 23(c)(1), 41, 42(a), 43 and 48(c) of the Internal Revenue Code of 1939[1] are set forth in Appendix I, pp. 53-54, *infra*.

Statement

This case is not, as the Government states (Br. 8-9), one where a taxpayer "pays a local property tax assessment under protest, and then sues to recover part of the payment"; it is a case where a taxpayer denies and contests an assessed valuation of its real property and, while the contest is pending, involuntarily pays the asserted tax liability resulting therefrom, because, as the Government admits (Br. 5), "it was necessary to stay the imposition of penalties and foreclosure of [the tax] liens." The two situations are not to be confused. Their difference is all important in applying the principles of income tax accrual established by this Court. It is, therefore, necessary to restate the facts with this in mind.

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[1] These provisions are the same as their counterparts in the Internal Revenue Code of 1954 and in prior Revenue Acts. Unless otherwise noted, statutory references will be made to the 1939 Code.

NOTE—Unless otherwise noted, italics in quoted matter is supplied.

The New York Law With Respect to Real Estate Taxes

Under the New York law

—the real estate tax liability for a given year[2] on a given parcel arises out of the separate actions of two municipal bodies (assessment of the value of the property by the City Tax Commission and establishment of the real estate tax rate by the City Council) which is then shown in the bills sent during the year to the owner—it is not the result of any self-assessment such as the filing of a state or federal income tax return;

—the bills thus sent are payable in two installments —½ on October 1 of the year in which the bill is sent, and ½ on April 1 of the following year;

—failure to pay the asserted tax liability when due, as billed, subjects the property to seizure and foreclosure of the tax lien, the same as a judgment lien and the only way to remove such tax lien is to pay the full amount of the installments of the tax when due, as billed;

—an aggrieved owner can contest only the assessed valuation of its property and may do so by the *exclusive* remedy provided by statute; namely, the timely filing of a prescribed protest with the City Tax Commission (by March 15) requesting reduction of the proposed valuation to a stated amount[3]

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[2] New York City is on a fiscal year basis (July 1-June 30).

[3] In *G. C. M. 25298*, C. B. 1947-2, 39 at p. 43, it is recognized that for accrual purposes "[t]he term 'contest' includes not only a contest in court • • • but a contest lodged with the tax authorities as well. (See *The Great Island Holding Corporation et al.* v. *Commissioner*, 5 T. C. 150; acq. C. B. 1945, 3)."; and more recently in Rev. Rul. 57-105, C. B. 1957-1, 193 at p. 194.

and, if unsuccessful, appealing therefrom by filing a timely petition for certiorari (by October 25) in the State Supreme Court; there is no other way to contest and obtain a redetermination of the valuation factor upon which the real estate tax liability is based and computed;

—where such a contest is conducted in accordance with the prescribed statutory procedures, the only proper and lawful real estate tax is the product of the tax rate established by the City Council and the value of the property ultimately determined in the certiorari proceedings;

—but such contest does not prevent the seizure of the property or the foreclosure of the tax lien thereon if the tax installments, as billed, are not paid,[4] as, by way of contrast, would be the case if a taxpayer sought review of a proposed income tax deficiency and filed a petition in the Tax Court which would automatically stay any further action thereon by the Commissioner. (R. 5-6, 17-18)

Agreement Of The Parties With Respect To The New York Law

The New York law, as above outlined had been one of the issues tried in the Court of Claims in an earlier suit for refund of federal income taxes for the years 1938, 1939,

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[4] Payment to prevent such seizure is considered involuntary and made under coercion. Judge Cardozo, speaking for the New York Court of Appeals in *People ex rel. Wessel Nickel & Gross v. Craig*, 236 N. Y. 100, 104, 140 N. E. 209, stated,

> "The tax becomes a lien at the time stated in the charter • • •. Payment made thereafter is not voluntary, for the menace of the lien with penalties added for delay • • • has the effect of rendering it *compulsory*. [citing cases]"

Cf. 5 *Williston on Contracts*, Sec. 1619A, pp. 4524-28 (Rev. Ed. 1937).

and 1941 which the Government admits (Br. 20) "was identical to this one, except that it involved different taxable years".[5] Nevertheless, these facts, which were fully set out in the claim for refund attached to the complaint herein (R. 17-18), along with other facts common to both suits, were again put in issue by the Government by the qualified admissions and specific denials in its answer (R. 36). After the District Court Judge, in connection with an earlier motion of the Government, had expressed the belief that the case presented no real factual issue,[6] the stipulation was entered into which amended the pleadings "to eliminate all issues of fact" and "to raise the sole issue of law" as stated at p. 2, *supra* (R. 4, § 3).

Respondent's Contest and Settlement Of The Assessed Valuations for 1946-1950 And The Involuntary Payment Of The Asserted Real Estate Tax Liabilities

In each of the years 1946-1950, Respondent duly contested the assessed valuations on some of its hundreds of parcels of New York City real estate by complying with the above-mentioned requisites of the exclusive statutory remedy, i.e., by filing timely *bona fide* protests with the City Tax Commission requesting reduction of the valuations of those parcels to the amounts therein stated to be their true value; and, after the requests were denied, by appealing therefrom in duly instituted "certiorari proceedings" in the New York Supreme Court for the judicial review of the contested assessed valuations (R. 5-6, 17-18, 21-22). Each petition in those proceedings, as required by New

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[5] See findings numbered 6-13, *Consolidated Edison Co. of New York* v. *United States*, 133 C. Cls. 376, 386-389. The citation used by the Government (135 F. Supp. 881) does not contain the Court's findings of fact.

[6] *Consolidated Edison Company of New York* v. *U. S.*, 162 F. Supp. 854, 856, fn. 4.

York law, set forth, as did the protests, the claimed value of each parcel, which value became the minimum value the Court could find (R. 6, 18). Thus the petition, *in effect*, admitted liability for the pro rata amount of the asserted tax and denied liability for the remainder; and the litigation, *in effect*, was confined to a determination of Respondent's real estate tax liability in excess of the amount thus admitted.

Respondent involuntarily paid under protest in each of the years in question the total amount of each installment of the asserted real estate tax liability. Payment was necessary to avoid seizure of the property by foreclosure of the tax liens. But by its protest, Respondent denied and contested its liability for the unadmitted portion of the tax and reserved all rights with respect thereto.[7] (R. 6, 9, 21). In 1951 the certiorari proceedings were settled, and the court entered orders thereon, reducing the contested assessed valuations but not to the extent originally claimed by Respondent. Whereupon the City refunded the resultant overpayment of taxes (R. 7, 9, 22).

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[7] The Government admits (Br. 5) that "payment was not a requisite to judicial review in the form of prescribed certiorari proceedings", yet it constantly refers to the certiorari proceeding as refund suits (Br. 8, 21, 22, 23, 27, 29).

For a sample of the protest which accompanied the payment, see Finding No. 17 in the Court of Claims decision of the *Consolidated Edison* case (133 C. Cls. at p. 391). These are the protests which the Government stresses and repeatedly cites in its brief. They are not required under the New York law and their only significance in the present case is to eliminate any possible inference that the payments indicated an intent to discontinue the pending contests of the disputed assessed valuations. The significant protests, which the Government ignores, are those required to be filed with the City Tax Commission. See pp. 3-4, *supra*; and pp. 20-21 and fn. 30, *infra*.

The Illustrative Example

To facilitate consideration of the questions presented, the parties have agreed upon, and the Court below adopted, the following illustrative example[8] (R. 10, 42) which is also set forth in Petitioner's brief, pp. 5-6:

(a) For the year 1949 plaintiff [Respondent] was notified, on January 25, 1949, of a tentative assessment in the amount of	$100.
(b) plaintiff duly filed by March 15, 1949, a *bona fide* protest, admitting a liability of	85.
and petitioning for an administrative reduction of said tentative assessment by	15.
(c) after hearing duly held and on or about May 25, 1949, final assessment was made in the amount of	100.
(d) thereafter on or about October 1, 1949, under protest and for the stated purpose of avoiding liens, seizures, levies, penalties, interest, etc., and reserving all rights, payment was made of..	100.
(e) on October 25, 1949, certiorari proceedings were duly instituted in the New York Supreme Court admitting liability of, and denying liability in excess of	85.
(f) in December 1951, the certiorari proceedings were settled, fixing the tax liability at	95.
and establishing an overpayment which was duly refunded, in the amount of	5.

Chronology of Disagreement Over Treatment of the Unadmitted and Contested $15.

Respondent, on a similar set of facts with respect to the years 1938, 1939 and 1941, was in disagreement with the Commissioner of Internal Revenue and was actively

[8] The discussions in both Petitioner's and Respondent's briefs are in terms of this illustrative example.

contesting his income tax treatment of the difference between the total asserted tax liability ($100) and the amount of Respondent's admitted liability ($85) in each of those years, referred to at pp. 4-5, *supra*. Respondent had maintained, with respect to the earlier years, as it does in the present case, that denial and contest of a tax liability bars accrual of the amount in contest for federal income tax purposes until the contest is resolved; and, therefore, in terms of the illustrative example,

(1) only $85, which it admitted to have been properly assessed, accrued and was deductible in the year of assessment, and

(2) of the unadmitted and contested $15,

(i) the $10 ultimately determined by the settlement to have been properly assessed, accrued and was deductible in the year of settlement; and

(ii) the $5 ultimately determined by the settlement to have been improperly assessed, and which was refunded, did not constitute taxable income, but was the return of an item which had no income tax consequence from the very beginning. Under the annual accounting principle of our income tax laws, the erroneous allowance of a deduction for the $15 in a prior year did not warrant taxing the $5 as income in the year of refund.

The Commissioner had ruled that Respondent was required to deduct $95 in each of the years 1938 and 1939 when the payments were made[9] but nevertheless was required to include the $5 refund in its gross income for

[9] This reflected the Commissioner's position in I. T. 3491, C. B. 1941-2, 177, that regardless of the delay in determining a contested tax liability, it accrues and is deductible only in the year for which it was imposed.

1941.[10] The correctness of these conflicting rulings[11] was put in issue in the aforementioned refund suits filed in the United States Court of Claims for the years 1938, 1939, and 1941 (R. 20-21).[12]

When Respondent filed its income tax returns for the years 1946 through 1951, it was still engaged in its contest with the Commissioner in regard to the income tax treatment of the $15 for the years 1938, 1939 and 1941. Nevertheless, Respondent complied with the instructions it had received from the Commissioner (*G. C. M. 25298*) regarding such treatment. In terms of the illustrative example, Respondent for each of the years 1946-1950, inclusive, took deductions of $100, instead of the $85 it believed was properly deductible; and for the year 1951—the year the New York City tax liability dispute was settled—Respondent failed to take the $10 deduction it believed was proper and included in its gross income the New York City refund of $5, which Respondent believed did not constitute income. This resulted in Respondent paying less federal income taxes for the years 1946-1950 and more federal income taxes for 1951, than it believed should have been paid.[13] In due course, Respondent filed its claim for refund of 1951 income taxes

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[10] This ruling was later published as *G. C. M. 25298*, C. B. 1947-2, 39, on the basis of which *I. T. 3491* was revoked. *I. T. 3863*, C. B. 1947-2, 141.

[11] For the chronology of the Commissioner's conflicting and changing positions in this area, see Appendix III, pp. 58-61, *infra*.

[12] When these earlier suits came up for argument in 1955, the Government contended, as it does in the present case, that (1) the entire $100 was deductible in the year of payment, and (2) the $5 refund was taxable income in the year of settlement.

[13] Should the Company succeed in obtaining a refund of the 1951 taxes, the Commissioner will have one year after entry of judgment herein to reaudit the Company's 1946-1950 returns and assess deficiencies based upon deductions already taken in those years with respect to the $15, in accordance with the provisions of Sections 1311-1315 of the Internal Revenue Code of 1954.

on February 10, 1955, based upon the position it had always maintained[14] as above set forth (R. 18-24); and the claim was rejected on March 28, 1955[15] (R. 15). On December 6, 1955, the Court of Claims decided the 1938-1941 refund suits in favor of the Government. *Consolidated Edison Company of New York, Inc.* v. *United States*, 133, C. Cls. 376; cert. den. 351 U. S. 909. Thereafter, the complaint in the present suit was filed in the United States District Court for the Southern District of New York on June 6, 1956; the District Court, on cross motions for summary judgment, granted the Government's motion (R. 3); and the Court of Appeals reversed, granting Respondent's motion, Swan, J. and Lumbard, C.J. (R. 39-47), Clark, J. dissenting (R. 47-50).

Summary of Argument

POINT I

Notwithstanding Respondent's obligation, under New York Law, to pay the contested $15, the denial and contest of that liability made it contingent, non-accruable and non-deductible, under Section 23(c)(1), until the litigation ended in 1951. *Dixie Pine Products Co.* v. *United States*, 320 U. S. 516. The "precise nature" of the interim involuntary payment of the $15 and its treatment for income tax purposes, had to await the outcome of the litigation. *Consolidated Edison Co.* v. *United States*, 279 F. 2d 152; *Doyle* v. *Commissioner*, 110 F. 2d 157; *Ralph A. Boatman*, 32 T. C. 1188; *The Dill Co.*, 33 T. C. 196 (appeal pending, C. A. 3). Only then, under the "all events" rule of *United States* v.

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[14] The Government incorrectly implies that it was Respondent, not the Commissioner, that had changed its position on this question. (Br. 6, 7 fn. 1, 12)

[15] On May 9, 1955, the Commissioner rejected an amended protective claim for refund based on a matter which was eliminated by the stipulation (Par. 1(b), R. 4).

Anderson, 269 U. S. 422, did the event occur to warrant accrual and deduction of $10. *Dixie Pine, supra*, at p. 518; *Security Flour Mills Co.* v. *Commissioner*, 321 U. S. 281, 286-87. The annual concept of our income tax laws require that the settlement of the contest be reflected in 1951, the year of settlement. *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359; *Security Mills, supra.*

POINT II

The legal principles of accrual, as set forth in Point I follow the Congressional intent that, absent countervailing administrative or revenue protection considerations, the accounting provisions of the Code be in accord with recognized commercial principles of accrual accounting. *Anderson*, 269 U. S. at p. 424; *Lewyt Corp.* v. *Commissioner*, 349 U. S. 237, 242-43.

Sound administration and solicitude for the revenue support, rather than militate against, the congruency between the legal principles and the commercial principles of accrual, in the present case. *Consolidated Edison Co.* v. *United States*, 279 F. 2d 152 (R. 46-47); cf. *Bressner Radio Inc.* v. *Commissioner*, 267 F. 2d 520, 528.

The Government's reliance upon its administrative ruling in *G. C. M. 25298*, C. B. 1947-2, 39, is an attempt to raise itself by its own bootstraps—for that ruling was issued to respondent on the very question now before this Court—and ignores the modification thereof in *Mim. 6444*, C. B. 1949-2, 11, that payment *per se*, i. e., payment of a contested tax "which is a prerequisite for further appeal"—is not a basis for accrual. There has been no uniform administrative construction on this question and the present rulings thereon are contradictory.

POINT III

The decisions of the Court of Claims in *Chestnut Securities Co.* v. *United States*, 104 C. Cls. 489, 62 F. Supp. 574, and *Consolidated Edison Co.* v. *United States*, 133 C. Cls. 376, 135 F. Supp. 881, upon which the Government relies, are contrary to the principles of accrual established by this Court.

The *Chestnut Securities* doctrine of the Court of Claims that "accrual precedes payment and does not survive it", was based upon that court's belief (1) that it was within the meaning of the tax laws,—a belief rejected by this Court in *United States* v. *Olympic Radio & Television Co., Inc.*, 349 U. S. 232, and (2) that it was within the terminology of accounting—a belief on which the Court of Claims reversed itself in its decision of the *Consolidated Edison Company* case. Appendix II, pp. 55-57, *infra*. The doctrine that "payment of an item which is otherwise accruable in the taxable year, accrues the item", which the Court of Claims enunciated in the *Consolidated Edison Company* case, is contrary to the principles of accrual established by this Court.

In complete disagreement with the Court of Claims are the decisions of the court below (R. 39-47), *Consolidated Edison Co.* v. *United States*, 279 F. 2d 152, cited with approval in *Schlude* v. *Commissioner*, 283 F. 2d 234, 238, pet. for cert. filed Jan. 4, 1961; and *Standard Oil Co. of Ohio* v. *United States*, 51 AFTR 1688, 56-2 USTC (CCH) Par. 10051.

The Government's assertion that the Tax Court has followed the Court of Claims, is not supported by the cases it cites.

POINT IV

It follows from Point I that the $5 refund is not taxable income in 1951. The annual accounting system of our income tax laws does not permit correction of the erroneous allowance of the $15 deduction in 1949, now closed by the statute of limitations, by including the $5 refund in Respondent's income for 1951. *McEachern* v. *Rose*, 302 U. S. 56, 62; *Commissioner* v. *Dwyer*, 203 F. 2d 522, 524-25; *Streckfus Steamers, Inc.*, 19 T. C. 1. Any relief or remedy available to the Commissioner with respect to the erroneous $15 deduction in 1949 is specifically provided for in Sections 1311-1315 of the Internal Revenue Code of 1954. Thereunder, the Commissioner will have one year after a decision herein in favor of the Respondent becomes final, within which to review the deduction of the $15 in Respondent's 1949 return and to assert a deficiency with respect thereto, in accordance with the provisions of said Sections 1311-1315.

ARGUMENT

POINT I

Under established principles of income tax accrual, the amount of a contested tax liability is contingent and non deductible under Section 23(c)(1) until the litigation is ended; an involuntary, compulsory payment thereof pending the outcome of the litigation does not, as a matter of law, accrue the amount as a deduction at the date of payment.

The deduction granted by Section 23(c)(1) for "[t]axes paid or accrued within the taxable year * * *" permits an accrual basis taxpayer to take the deduction only for taxes *accrued*—and not for taxes *paid*—within the taxable year.

United States v. *Olympic Radio & Television Inc.*, 349 U. S. 232; *Lewyt Corporation* v. *Commissioner*, 349 U. S. 237.

Although payment may be germane as evidence of an admission of liability which, in turn, would be a basis for accrual, that is not the situation here. (R. 5-6)

The question in the present case is solely one of law—whether payment, *per se*, accrues a contested tax liability. We submit that, under the principles of income tax accrual established by this Court, the involuntary, compulsory payment of the unadmitted and contested $15 tax liability did not, *as a matter of law*, accrue that liability in 1949; and that $10 thereof first accrued when the litigation ended in 1951.

Income Tax Accrual is a "Technical Concept"—"All Events Rule" of *Anderson*

Accrual under the income tax laws is a "technical concept"; it "embodies the annual accounting principle"; and "is to be determined in accord with normal accounting concepts relevant to the accrual basis."[16] The application of this "technical concept" to Section 23(c) has its roots in what is commonly referred to as the "all events rule",—that for a tax liability to accrue "* * * all the events may [must] occur which fix the amount of the tax and determine the liability of the taxpayer to pay." *United States* v. *Anderson*, 269 U. S. 422, 441;[17] *Dixie Pine Products Co.* v. *Commissioner*, 320 U. S. 516, 519; *Security Flour Mills Co.* v. *Commissioner*, 321 U. S. 281, 284.

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[16] *Lewyt Corporation* v. *Commissioner*, 349 U. S. 237, 242-43.

[17] The "all events" rule is also applicable in the accrual of gross income (*Spring City Foundry Co.* v. *Commissioner*, 292 U. S. 182, 184) and non-tax deductions (*Brown* v. *Helvering*, 291 U. S. 193).

"Contested Tax Liability Test" of *Dixie Pine*—Another Facet of the All Events Rule

The "all events" rule posed no problem where, as in *Anderson*, the tax liability was admitted and uncontested;[18] but differences arose where the tax liability was denied and contested. On the one hand, it was maintained that the denial and contest of a *tax* liability made it contingent and dependent upon the outcome of the litigation,[19] just as in the case of an unadmitted and contested *non-tax* liability.[20] On the other hand, it was maintained that a different rule applied to a contested *tax* liability—that by virtue of the obligation created by the tax imposing statute, all events had occurred to fix the liability in the year *for* which the tax was imposed.[21] Between these two contentions were numerous conflicting exceptions and distinctions.[22] The

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[18] In such a situation the tax liability "confessedly accrued". *Lucas* v. *American Code Co.*, 280 U. S. 445, 452.

[19] *Dixie Pine Products Co.* v. *Commissioner*, 134 F. 2d 273.

[20] *Lucas* v. *American Code Co., Inc.*, 280 U. S. 445.

[21] *Davies' Estate* v. *Commissioner*, 126 F. 2d 294; *J. A. Dougherty's Sons, Inc.* v. *Commissioner*, 121 F. 2d 700; *Commissioner* v. *Central United National Bank*, 99 F. 2d 568.

[22] Originally, an unconstitutional tax statute was deemed a nullity (*Norton* v. *Shelby County*, 118 U. S. 425, 442) and could not serve as a basis for a *tax* deduction; but a payment thereunder might be claimed as a *loss*. *E. L. Bruce Co.*, 19 B. T. A. 777. Later, such a statute was considered an operative fact (*Chicot County Drainage District* v. *Baxter State Bank*, 308 U. S. 371, 374), which could be taken into consideration for accrual purposes until declared invalid. *Cartex Mills, Inc.*, 42 B. T. A. 894. Conflicting views arose as to whether the determination of unconstitutionality in a later year called for adjustment in the year for which the tax was imposed, or in the year the law was declared invalid. Some inquired whether the taxpayer could be "made whole" in the earlier year. Others disregarded the "made whole" theory and held that, subject to the statute of limitations, adjustment should be made in the year for which the tax was imposed. See review of some of the cases in *E. B. Elliott Co.*, 45 B. T. A. 82, 87-93, and the dissenting opinions, pp. 95-96. These views also cut across cases involving a contested liability under a valid tax law.

Commissioner, uncertain as to which of the conflicting theories to adopt, changed his official position, from time to time;[23] and even then failed to follow such position when, in a given instance, it was to the interest of the revenue not to do so.[24] As a result he found himself taking inconsistent positions not only with respect to different taxpayers but even with respect to the same taxpayer.[25]

Out of this confused background arose *Dixie Pine Products Co.* v. *Commissioner*, 320 U. S. 516. There, the taxpayer denied and contested its liability for a Mississippi tax and did not pay the tax. Nevertheless, it sought to accrue and deduct the tax liability under Section 23(c). Addressing itself to the underlying cause of the prevailing confusion, this Court held that the denial and contest of liability under a tax statute was the critical fact which prevailed over the interim obligation created by the statute;—that notwithstanding such statutory obligation, the contest made the tax liability contingent, non-accruable and non-deductible under Section 23(c), until the contest was terminated, saying (p. 519):

> "It has long been held that in order truly to reflect the income of a given year, all the events must occur in that year which fix the amount and the fact of the taxpayer's liability for items of indebtedness deducted though not paid; and this cannot be the case where the liability is contingent and is contested by the taxpayer."

And in answer to the contention that a different rule should be applied to contested *tax* liabilities, this Court continued:

> "Here the taxpayer was strenuously contesting liability in the courts and, at the same time, deducting

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[23] The published rulings reflecting the various changes of the Commissioner are set forth in Appendix III, pp. 58-61, *infra*.

[24] E. g., *Lehigh Valley Railroad Co.*, 12 T. C. 977, 997-998 and fn. 2, p. 998.

[25] See pp. 8-9 *supra*, where the Commissioner took inconsistent positions with respect to Respondent for the years 1938-1941.

> the amount of the tax, on the theory that the state's exaction constituted a fixed and certain liability. This it could not do. It must, in the circumstances, await the event of the state court litigation and might claim a deduction only for the taxable year in which its liability for the tax was finally adjudicated."

The Government argues that, by use of the phrase "though not paid" in the first of the above-quotations, this Court stressed the non-payment of the disputed tax and made it a prerequisite for non-accrual. (Br. 18-19) When read in context, however, it is obvious that the contrary is true; that in rejecting the taxpayer's argument that payment of the tax is the basis for accrual, this Court considered payment an irrelevant factor—that a tax may accrue *even though* it is not paid; and, as the second quotation shows, this Court did not mean that payment of a tax under protest as an unavoidable incident of contesting liability, would fix liability.

Dixie Pine and *Anderson* complement each other as different facets of the "all events" rule. Where the tax liability is admitted or uncontested, all events have occurred to fix the liability to warrant accrual and deduction under Section 23(c). But where the tax liability is denied and contested, the event fixing the liability first occurs when the contest is ended; until then the tax liability is contingent and is not accruable or deductible under Section 23(c).

The Government, in the present case, would revive the contention (clothed in a somewhat different garb) which *Dixie Pine* rejected. It would ignore the denial and contest of the tax liability and would emphasize Respondent's involuntary payment of the amount of the tax it was contesting as the critical accrual event—just as in *Dixie Pine* the taxpayer sought to ignore the denial and contest of the tax liability and emphasized the obligation created by the tax imposing statute as the critical accrual event. But Respondent's involuntary payment of the contested $15—that is, the

$15 over and above the $85 which it admitted it owed—was made under compulsion or duress and did not terminate the contest.[26] In the language of *Dixie Pine*, it was still necessary "in the circumstances, [to] await the event of the State court litigation" to ascertain the amount, if any, of the contested liability. Under *Anderson* and *Dixie Pine*, the settlement in 1951 was the accrual event which, for the first time, "fixed" the contested $15 liability at $10.

Payment of a Contingent Liability Does Not Accrue Such Contingent Liability as a Deduction

The Government's contention that payment, *per se*, is a basis for accrual, would eliminate the fundamental distinction between cash and accrual basis taxpayers and would put an accrual basis taxpayer on "a divided and inconsistent method of accounting not properly to be denominated either a cash or an accrual system". (*Security Mills*, 321 U. S. at p. 287). Contrary to *Olympic Radio* and *Lewyt*, it would also change the meaning of Section 23(c) and grant a deduction to cash basis taxpayers for "taxes paid", and to accrual basis taxpayers for "taxes paid or accrued".

Moreover, it misconceives the rationale of *Dixie Pine*. Under that rationale the denial and contest of liability for the $15 made that liability contingent, non accruable and non deductible under Section 23(c) until the contest ended. Respondent's interim involuntary payment of that contingent $15 liability did not end the contest or fix the amount of the contested liability. (p. 4, *supra*). As stated by the Court below, per Swan, J. (R. 45):

> "A payment may constitute a capital expenditure, an exchange of assets, a prepaid expense, a deposit or a current expense. When the exact nature of the payment is not immediately ascertainable because it depends on some future event, such as the out-

[26] See p. 4 *supra*.

come of litigation, its treatment for income tax purposes must await that event." *Consolidated Edison Co. v. United States*, 279 F. 2d 152, 156.

Similarly, *Doyle* v. *Commissioner*, 110 F. 2d 157. Cf. *Commissioner* v. *Gillette Motor Transport, Inc.*, 364 U. S. 130, 133;[27] *Ralph A. Boatman*, 32 T. C. 1188; *Dill Co.*, 33 T. C. 196. The "precise nature" and character of the payment is determinative of its income tax treatment.[28]

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[27] "• • • if is necessary to determine the *precise nature* of the property taken" to determine its tax treatment.

[28] For the different tax treatment of different types of payments, see also *Commissioner* v. *Boylston Market Assn.*, 131 F. 2d 966, 968, where an insurance premium payment covering more than one year was considered a capital expenditure rather than a current expense (overruling the court's contrary decision in *Welch* v. *DeBlois*, 94 F. 2d 842), and *Waldheim Realty & Inv. Co.* v. *Commissioner*, 245 F. 2d 823, 824, where such insurance premiums payments were considered a current expense (in agreement with *Welch* v. *DeBlois*, *supra*); *R. D. Cravens*, 30 T. C. 503, where payment for feed to be delivered the following year was considered a deposit rather than a current expense; the reversal of that case in *Cravens* v. *Commissioner*, 272 F. 2d 895; and *John Ernst*, 32 T. C. 181, where a payment for feed to be delivered the following year was considered a current expense rather than a deposit; *Veenstra & DeHahn Coal Co.*, 11 T. C. 964 and *Federal Machine & Welder Co.*, 11 T. C. 952, 1956 where receipts were considered deposits for future sales rather than current income; *Richard M. Drachman*, 23 T. C. 558 where the payment was considered a loan rather than a business expense or capital contribution; *Unitex Industries, Inc.*, 30 T. C. 468, payments to subscribers of preferred stock during the period of installment payments on account of the subscriptions were considered payments to stockholders rather than payments of interest or expense; and *Rev. Rul. 59-184*, 1959-1, C. B. 65, 68, where premium payments on the lives of two principal stockholders were considered an exchange of assets, cash for insurance policy, rather than a dividend distribution.

In the *Doyle* case, the "precise nature" of the forfeited payments received under an executory real estate sales contract, and their treatment for income tax purposes, was determined and reflected in the year of forfeiture—not in the earlier year of receipt. In the present case, the payment of the contested $15 no more characterized it for income tax purposes than did the initial payments in the *Doyle* case. It was still necessary, under *Anderson, Dixie Pine* and *Doyle*, to await the outcome of the contest to determine the "precise nature" of the payment and its treatment for income tax purposes.

Nor does the Government's argument (Br. 21-22, 26-30) that payment extinguished the liability bring it closer to accrual under Section 23(c). Payment of the amount of the non contested tax liability ($85) extinguished a liability that was fixed and deductible for income tax purposes. But the statutory protest and denial of liability for $15 of the asserted liability, and the institution of the certiorari proceedings to enforce the validity of its protest rendered that portion of the asserted tax liability contingent and non deductible, under *Dixie Pine*, until the precise amount of that additional liability, if any, had been determined. Until then the payment of the disputed amount had no income tax consequence; it merely exchanged one asset (cash) for another (a deposit, deferred expense or other account receivable.)[29]

The Government's reliance upon *Rosenman* v. *United States*, 323 U. S. 658, and *Lewyt Corp.* v. *Commissioner*, 215 F. 2d 518 (Br. 27-29), shows that it regards the New York system of taxing real estate similar to the Federal system of taxing income and decedent estates. In fact, the two systems are fundamentally different, particularly in

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[29] For the treatment of such payments under recognized principles of accrual accounting, see Appendix II, pp. 56-57, *infra*.

matters of accrual. The tax liability under the Federal systems arises out of an "assessment" which cannot take place (except in the extraordinary case of a jeopardy assessment) without the express or tacit consent of the taxpayer, i.e. by way of self assessment on the filing of a return or failure to oppose a proposed deficiency by failing to file a petition in the Tax Court. Such express or tacit consent, under *Anderson*, is a proper basis for accrual. The tax liability under the New York system, however, arises, not out of any such "assessment" of tax, but out of the actions of two separate municipal bodies (see p. 3, *supra*) regardless of the taxpayer's consent or opposition. The asserted tax liability may be enforced by virtue of the City's power of distraint, notwithstanding the taxpayer's opposition thereto or the pendency of New York certiorari proceedings, duly instituted by the taxpayer to review the correctness of the assessed valuations upon which the asserted tax liability was computed.[30] The contest of the asserted real estate tax liability by compliance with the State statutory require-

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[30] See p. 4, *supra*. As stated in fn. 7, p. 6, *supra*, the state certiorari proceedings would have been maintainable, and could have been prosecuted, even if the real estate tax bills issued by the City had not been paid. There is no suit available for the refund of New York City real estate taxes, such as there is for the refund of Federal estate or income taxes (*U. S. Trust Co.* v. *Mayor, etc. of New York*, 144 N. Y. 488, 39 N. E. 383; *Swift* v. *City of Poughkeepsie*, 37 N. Y. 511); or for any method of reviewing the assessed valuation of the property involved other than by the exclusive certiorari proceedings provided by the New York statutes. *Sikora Realty Corporation* v. *New York*, 262 N. Y. 312, 186 N. E. 796, rearg. den. 262 N. Y. 636, 188 N. E. 99; *Nat Friedman & Son, Inc.* v. *New York*, 262 N. Y. 665, 188 N. E. 112; *New York Central Railroad Co.* v. *Limburg*, 261 App. Div. 562, appeal denied 262 App. Div. 746, appeal dismissed 286 N. Y. 605, 35 N. E. 2d 942; *People ex rel. Staten Island Rapid Transit Co.* v. *Taylor*, 247 App. Div. 405, 287 N. Y. S. 456; *Young Women's Christian Association* v. *New York*, 217 App. Div. 406, affd. 255 N. Y. 562, 157 N. E. 858.

ments (see pp. 3-4, *supra*) would under *Dixie Pine*, make that asserted liability contingent and non accruable until the end of the contest. Only recently, this Court took cognizance of this distinguishing characteristic of the Federal System in various systems of taxation, when it stated, "Our system of [federal income] taxation is based upon voluntary assessment and payment, not upon distraint", *Flora* v. *United States*, 362 U. S. 145, 176, citing *Helvering* v. *Mitchell*, 303 U. S. 391, 399.[31]

The essential point of the Government's argument appears to be in the statement (Br. 29), "The taxes had already been assessed by the City * * *. Taxpayer was left with only a claim for refund which might or might not materialize in a later year." From this premise the Government argues that the decisions in *Rosenman* and *Lewyt*, *supra* (p. 20), support its position that the unadmitted and contested $15 accrued when it was involuntarily paid pending the outcome of the contest.

But, as we have already shown, this premise misconceives the true nature of liability under the New York system of taxation—and neither the *Rosenman* nor the *Lewyt* decision supports the Government's position. The *Rosenman* case did not involve any question of accrual. It involved only the application of the statute of limitations on refund claims. The refund claim, which is the foundation for the action at law to recover alleged excess tax payments, was filed in 1940. This was more than three years following the remittance in 1936, which was placed in a Suspense Account, and within three years of the date the taxes were

[31] The division of opinion in the *Flora* case was not addressed to this observation but to the proper path to be followed from that point; namely, whether or not, after the assessment is made, it is necessary that it be paid in full before a refund suit may be commenced.

assessed and paid by application of the monies thus remitted. As this Court stated in that case (323 U. S. at p. 661), "It is this erroneous assessment that gave rise to a claim for refund. Not until then was there such a claim as could start the time running for presenting the claim. In any responsible sense *payment* was then made by the application of the balance credited to the petitioners in the suspense account and by the additional payment of $10,497.34 on April 22, 1938." Under the self assessment concept of the Federal estate tax laws, there can be no such assessment without the express or tacit approval of the taxpayer. The Government attempts to bring the present case under the *Rosenman* decision by arguing that payment of the $15 was "in discharage of an asserted tax liability". (Br. 29) Completely ignored is the fact that the payment of the $15 was the payment of a *contingent* liability whereas the payment in the *Rosenman* case was the payment of a tax liability already *fixed* by the "assessment". In the present case the "precise nature" of the item paid was yet to be determined (see pp. 17-19, *supra*).

Similarly, an incidental issued decided by the Court of Appeals in *Lowyt* (which did not reach this Court), was whether remittances to the Collector in 1947 in payment of proposed excess profits tax deficiences, which were then being contested in the Tax Court, constituted "payment" of tax within the contemplation of the statute. The "assessment" of the proposed deficiences was barred because of the contests pending in the Tax Court.[32] The taxpayer, under the erroneous belief that a settlement of the contested liabilities had been effected with the Commissioner, made remittances to the Collector in 1947 in the full amount of the

[32] Section 272 specifically provides that "No assessment of a deficiency in respect of the tax imposed by this chapter and no distraint or proceeding in court for its collection shall be made, begun or prosecuted * * * if a petition has been filed with the Board, until the decision of the Board has become final."

settlement negotiation. These payments were placed in a "Suspense Account" because there were no "assessments" against which they could be credited. In 1948, a final settlement was effected and the resultant deficiences were thereupon "assessed", and the monies which, in 1947 had been remitted and placed in a Suspense Account, were then applied towards the *payment* of those "assessments".

The main issue in the case was taxpayer's claim that "paid or accrued", as used in Section 122(d)(6), could be read in the alternative to enable it, an accrual basis taxpayer, to make Section 122(d)(6) adjustments for taxes "paid" in 1947. In the incidental issue, the taxpayer conceded that it could only make Section 122(d)(6) adjustments for taxes "accrued" in 1947; but maintained that, under *Chestnut Securities*, payment of contested taxes accrued them and that the 1947 remittances which were placed in a Suspense Account constituted such payments. The Commissioner admitted that this would be true if the 1947 remittances constituted "payments" of *tax*, but maintained that they did not. Thus, the only question presented to the Court of Appeals on this point was whether the 1947 remittances constituted "payments" of *tax*. The Court held, on the basis of the *Rosenman* case, that the 1947 remittances did not constitute "payments" of the contested tax liabilities.

The self assessment system of the federal income tax law should not be confused with the distraint system of the New York City real estate tax. The focal point of the federal income tax system, like that of the federal estate tax system with which *Rosenman* was concerned, is the *assessment* of the tax. Thus, the Government's reliance in the present case upon *Lewyt* (Br. 28-29) to support its claim that satisfaction of an asserted liability constitutes a "payment" of tax ignores the fact that the Court, in *Lewyt*, was addressing itself to an asserted tax liability which becomes fixed by the assessment of the tax (which in turn could not

take place without the express or tacit approval of the taxpayer). This is made clear by the sentences in *Lewyt* which follow the passages quoted by the Government (215 F. 2d at p. 523):

> "Or it [satisfaction] may follow from the payment of an asserted liability in advance of assessment * * * *if* * * * the payment is accompanied by the taxpayer's acquiescence in the proposed deficiency. The same holds true as to § 271(a)(1)(B), 26 U. S. C. A. § 271(a)(1)(B), requiring that amounts 'collected without assessment' be excluded from the computation of a deficiency, for *here again acquiescence by the taxpayer in such collections as constituting satisfaction of part of his tax liability is a condition necessarily to be implied.* In short, *there can be no payment without satisfaction whether pursuant to or apart from an assessment.* Here the taxpayer was tendering its check with one hand, and contesting its liability to pay with the other."

If any analogy were to be drawn between the present case and the *Lewyt* case, it would be to say that the New York certiorari proceedings was similar to the filing of a petition in the Tax Court to review a proposed deficiency. The real difference between the two, however, is the underlying basis of the respective systems of taxation. Under the Federal system of self assessment the filing of such a petition automatically stayed the assessment and collection of the proposed deficiency in *Lewyt* so that there was no "assessed" tax liability which could be "satisfied"; whereas under New York system of distraint, the filing of a petition in the certiorari proceedings did not stay the collection of the tax.

In relying upon *Rosenman* and the Court of Appeals' decision in *Lewyt*, the Government avoids the real issue in this case—whether the involuntary, compulsory payment of the contested real estate tax liability pending the outcome

of the contest, *as a matter of law*, accrues the contested liability as a deduction under Section 23(c), or whether the "precise nature" of the payment must await the outcome of the contest.

Admittedly, only one half of the asserted real estate tax liability in the present case was due on October 1 of each taxable year (R. 6), which half was duly paid in that year (R. 9); and the other half was first due on April 1 of the following year and was duly paid in that following year. Yet the Government would have the "certiorari proceedings", commenced in the taxable year, deemed a "refund suit" for taxes which had not yet been paid. Moreover, the amount actually paid in the taxable year, on account of the first installment of the asserted tax liability was less than the amount which Respondent admitted it owed to the City.[33] A suit for a tax refund is for the recovery of an *overpayment of tax legally due*—it is in the nature of a common law action "in assumpsit"—and is a suit on an *accrued* right for money had and received by reason of the improper or illegal collection of an asserted tax,[34]—a remedy which has been incorporated in our federal statutes, "for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected".[35]

The "Annual Accounting Principle" Of *Security Mills*

The history and background of *Dixie Pine* indicates that its rationale was intended to be broadly applied to

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[33] In terms of the figures in the illustrative example, the Government claims that Respondent, having paid $50 on account of the asserted tax liability in October of the taxable year, by filing the petition for certiorari in the New York Supreme Court that same month, in which it in effect admitted liability for $85, thereby commenced a suit for refund when it had not yet paid the amount that it admitted it owed.

[34] See, *Elliott* v. *Swartwout*, 10 Pet. 137; *Philadelphia* v. *Collector*, 5 Wall. 720; *Lowe Bros. Co.* v. *United States*, 304 U. S. 302; *Kings County Savings Institution* v. *Blair*, 116 U. S. 200; *Rock Island A. & L. R. R. Co.* v. *United States*, 254 U. S. 141.

[35] 28 U. S. C. § 1346 (a)(1)

eliminate the confusion which the various distinctions and exceptions had created. That rationale made it unnecessary for this Court to pass upon the Government's alternative argument in that case; namely, that in any event the Commissioner could relate back to the taxable year, and reflect therein, the ultimate result of the litigation which ended in the later year.[36] The last sentence in the quotation from *Dixie Pine, supra* (p. 16)[37] answered this alternative argument and presaged the decision rendered a few weeks later in *Security Flour Mills Co.* v. *Commissioner*, 321 U. S. 281, which refused to permit the "transactional" approach and upheld the "annual accounting principle" established by this Court in *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359.[38]

The Government quotes at length from *Security Mills* (Br. 18) to support its claim that only unpaid contested taxes are not accruable. The history of that case[39] contradicts this claim. The non-payment of the tax in *Security Mills*, as in *Dixie Pine*, was not a factor in its determination.

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[36] See Point II of Government's Brief in *Dixie Pine*—October 1943 Term, No. 84. In that case, the taxpayer's denial and contest of liability for the Mississippi tax had been decided ultimately in taxpayer's favor. The Government argued, alternatively, that by relating back that ultimate determination of no liability to the taxable year, there was no State tax liability in the taxable year for which the taxpayer could take a deduction under Sec. 23(c).

[37] "It must, in the circumstances, await the event of the State Court litigation and might claim a deduction only for the taxable year in which its liability for the tax was finally adjudicated."

[38] The *Security Mills* case "has nevertheless been mistakenly regarded on occasion as identical in issue and resolution to such cases as *Dixie Pine Products Co.* v. *Commissioner*, 320 U. S. 516, which have held that accrual taxpayers who refuse to pay taxes on the ground of their invalidity may not accrue and deduct the liability to pay them during the course of the dispute". *Bressner Radio Inc.* v. *Commissioner*, 267 F. 2d 520, 528.

[39] "Upon this point a page of history is worth a volume of logic." Mr. Justice Holmes in *New York Trust Co.* v. *Eisner*, 256 U. S. 345, 349.

The taxpayer, in *Security Mills,* on the annual accrual basis, paid during the first four months of 1935 the monthly AAA taxes imposed upon it as a first domestic processor of wheat; and then refused to pay these taxes for the balance of the year. In a suit to enjoin their further collection, it obtained a temporary injunction upon condition that it continue to file monthly AAA information returns and pay the tax therein disclosed, to a designated depository; which it did.

In determining the lump sum price of the flour to be charged its customers, the taxpayer included the AAA tax as part of its cost (which for illustrative purposes will be assumed to be 5¢ per barrel). The sales were made under a uniform miller's contract which provided for adjustment in price to reflect any increase or decrease in taxes; but when the AAA was declared unconstitutional on January 6, 1936 and the monies paid to the depository were returned to it, the taxpayer maintained that this clause was inapplicable. Nevertheless, it did make refunds of 3¢ per barrel to some of its customers in 1936, 1937, and 1938.

In its 1935 federal income tax return, the taxpayer accrued and deducted under Section 23(c) both the AAA taxes it paid the Collector during the first four months—which the Commissioner allowed—and the AAA taxes it refused to pay the Collector during the balance of the year but had paid to the depository under the injunction order—which the Commissioner disallowed. As to the latter, the taxpayer argued: (1) the 5¢ per barrel should be excluded from gross income because it represented the AAA tax transmitted to it by its customers for payment to the Collector; (2) even if the 5¢ were includible in gross income, taxpayer became obliged, under the miller's contract, to repay it when the AAA was declared unconstitutional, and (3) in any event, the 3¢ refunded to its customers in 1936-1938 was (under Section 23(a)) an ordinary and necessary expense of its sales in 1935 and should (under Section 43) be related back to 1935 "in order to clearly reflect income" of that year.

The Board of Tax Appeals sustained only the last of the taxpayer's contentions.[40] The Commissioner—not the taxpayer—appealed from this determination, which brought up only the question of relating back the refunds of 3¢ in 1936-38 to 1935 as expenses under Section 23(a).[41] The Court of Appeals reversed and held that the taxpayer may not relate back to 1935 the events which occurred in 1936-1938.[42] This was the only issue in the taxpayer's appeal to this Court, as was acknowledged by the Court itself.[43]

When taken in this context, it is clear that the Government's quotation from *Security Mills* (Br. 18) was part of the recital of the background of the case to establish the fact that the disputed and unpaid AAA taxes were part of the purchase price received by the taxpayer on the sales of flour in 1935 and that these were the sales—the transactions—to which the taxpayer sought to relate back the refunds made to its customers in 1936-1938. This Court had at the beginning pointed out that the amounts of the AAA taxes which were paid during the first 4 months of 1935 were not involved. A reading of the entire decision does not sustain the Government's assertion that this Court in *Security Mills* "stressed that the liability there involved had not been paid" (Br. 18-19). This Court's reference to the AAA tax "not paid to the Collector" and which the taxpayer "failed to pay" could more reasonably be ascribed to distinguishing the taxes paid during the first four months, which were not before this Court, from the unpaid taxes of the remaining 8 months, which were before this Court.

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[40] *Security Flour Mills Co.*, 45 B. T. A. 671.

[41] The taxpayer appealed from the Board's decision with respect to the income tax treatment of the refund of the AAA taxes paid during the first four months of 1935 and was sustained by the Court of Appeals.

[42] *Security Flour Mills Co.* v. *Commissioner*, 135 F. 2d 165.

[43] *Security Flour Mills Co.* v. *Commissioner*, 321 U. S. 281, 283. "The propriety of the claimed deduction depends upon the construction of §§ 23(a), 41 and 43 of the Revenue Act of 1934."

It was generally believed that *Dixie Pine* and *Security Mills* had rounded out the "all events" test of *Anderson*. The Commissioner, nevertheless, sought to restrict their application when it was in the interest of the revenue to do so, and continued to argue that a distinction should be drawn between relating back the events affecting a *non-tax* liability to the year of the original transaction (which *Security Mills* held may not be done) and relating back the outcome of a contested *tax* liability to the year for which the tax was asserted (which the Commissioner claimed in *Dixie Pine* should be done). But this attempt proved unsuccessful. *Stanard-Tilton Milling Co.*, 3 T. C. 1026, 1029-30 (Second Issue).[44]

The Government's attempt in the present case to restrict the contested liability rule of *Dixie Pine* to unpaid contested taxes is of a similar character. It also seeks to revert back to the fragmentation of the accrual concept which had occurred before *Dixie Pine* and *Security Mills*, and is a further contribution to the existing "jungle" in the accounting area of income tax law.[45]

Finally, the Government misconceives, or misapplies, the "transactional" theory when it states (Br. 22) that Respondent urges, contrary to *Security Mills*, a "transactional" treatment of items of income and expenses. Respondent's position is directly contrary to the "transactional" approach in that Respondent urges the deduction of the $10 in 1951 when the contested and contingent tax liability became fixed, and does not seek to relate back the deductions to 1949, the year *for which* the tax was imposed, as did the taxpayer in *Security Mills*.

It should be noted in conclusion of this Point that even the dissenting opinion of Judge Clark, in the court below,

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[44] The Commissioner first non acquiesced in that decision. C. B. 1944, 48. Not until about 5 years later did he finally withdraw his non acquiescence and acquiesce in it. C. B. 1949-1, 3.

[45] See dissenting opinion of Judge Friendly in *Commissioner* v. *Fifth Ave. Coach Lines*, 281 F. 2d 556, 563.

does not uphold the Government's contention that this Court in *Dixie Pine* and *Security Mills*, made non-payment a prerequisite for non-accrual. The dissenting opinion merely stated that in neither case "is there any holding that tax liabilities already paid should not be accounted for tax-wise until all disputes have somehow been put to rest" (R. 50). Of course there was no such holding—nor was there any holding, as the Government claims, that non-payment of the contested tax is a prerequisite for non-accrual. As previously noted, non-payment was only an incidental fact, and in no manner a decisive factor in the decisions of both cases.

We submit that under the principles of accrual established by this Court, the denial and contest of the disputed $15 real estate tax liability for 1949 made it contingent, non-accrual and non-deductible under Section 23(c); the involuntary payment thereof in 1949 pending the outcome of the litigation, did not accrue the contested $15, but constituted the payment of a contingent obligation which, for income tax purposes, had to await the outcome of the litigation to determine the nature and character of the payment; and the settlement of the contest in 1951 was the event which fixed the contested liability at $10 for purposes of accrual and deduction under Section 23(c).

POINT II

Respondent's position follows the congressional intent that, absent countervailing administrative or revenue protection considerations, income tax accrual should coincide with recognized principles of accrual accounting.

It is, of course, most desirable that income tax accrual concepts be in accord with recognized principles of accrual accounting. But administrative and revenue protection considerations may require income tax accounting to be

somewhat more precise and exact[46] and to be based upon objective, rather than subjective, criteria. Consequently, income tax accrual does not envisage the use of "estimates", as distinguished from "fixed" amounts, in determining income on the accrual basis.

The Congressional Intent That Income Tax Accrual Coincide With Recognized Principles of Accrual Accounting

These conflicting considerations were recognized from the very outset when this Court, in *Anderson*, stated that the accounting sections of the income tax law "indicate with no uncertainty of purpose" that "[i]t was to enable taxpayers to keep their books and make their returns according to scientific accounting principles * * *"[47] and then proceeded to establish the *legal* principles of income tax accrual which are embodied in the "all events" rule discussed at pp. 14-17, *supra*.[48] The enactment of Sections 452 and 462 of the 1954 Code was another step in the desire to bring the legal and commercial accrual concepts more closely together and to permit income tax accrual to be based upon "estimates";[49] but the realization

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[46] See "Time For Accrual of Income and Expenses" by William M. Emery, New York University Seventeenth Annual Institute on Federal Taxation, pp. 183-186 (1959).

[47] 269 U. S. at p. 440. Indeed, Section 48(e) specifically provides for the use of taxpayer's "method of accounting" in computing net income (§ 41), determining gross income (§ 42) and allowing deductions (§ 43).

[48] Scientific accounting principles not only take into consideration events which *fix* rights and duties, in determining income on the accrual basis, but also, in the absence of such "fixing events", permit *estimates* to be made for such purposes. Income tax accrual, however, is restricted to "events" which *fix* both the fact and the amount of the right or duty.

[49] See House Report No. 1337 on H. R. 8300, 83rd Cong., 2d Sess., (1954) pp. A 159, 162-163; and Senate Report No. 1622 on H. R. 8300, 83rd Cong., 2d Sess., (1954) pp. 301-303, 305-307. It should be observed that even then, Congress recognized that "Reserves created * * * for specific expenses and losses that are being *contested* or are in litigation * * * are *not* to be the basis for additions to reserves under this section." *Idem*, pp. 163 and 307, respectively.

of the tremendous revenue loss resulting from the unexpected applications of those sections prompted their retroactive repeal.[50] As stated by the Senate Finance Committee[51]:

> "Your committee desires to make its position clear that it expects to report out legislation dealing with prepaid income and reserves for estimated expenses at an early date. As indicated above, the existing rulings of the Treasury Department and the court decisions dealing with estimated expenses and prepaid income are now in such a state of confusion and uncertainty that in the opinion of your committee legislative action is required on these subjects. *In addition, your committee believes that it is essential that the income tax laws be brought into harmony with generally accepted accounting principles.* Moreover, your committee believes that the present status, where some taxpayers are able to defer prepaid income while others are not, is inequitable and should not be allowed to continue. In order to eliminate this uncertainty and discrimination, definite rules must be written into the income tax law. For these reasons your committee plans to begin studies in the near future to devise proper substitutes for the sections now being repealed."

Respondent's position in the present case is in complete accord with the recognized principles of accrual accounting;[52] and we submit, there are no countervailing administrative or revenue protection considerations to the contrary.[53]

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[50] See House and Senate Reports on H. R. 4725, 84th Cong., 1st Sess., C. B. 1955-2 at pp. 853-855 and 859-861, respectively.

[51] C. B. 1955-2, at p. 861.

[52] Appendix II, pp. 55-57, *infra*.

[53] Cf. *Bressner Radio, Inc.* v. *Commissioner*, 267 F. 2d 520, 528: "Absent an express Congressional command, a lack of congruency between the accrual methods authorized under § 41 and sound accounting practice must arise out of the demonstrable requirement of sound administration of the revenue laws."

Respondent's Position In The Present Case Accords With The Recognized Accounting Principles That Payment, *per se*, Has No Effect Upon Accrual

The recognized accounting principles on the accrual basis, applicable in the present case, were put in issue, and the Court of Claims made specific findings thereon, in *Consolidated Edison Company* v. *United States*, 133 C. Cls 376, 397-398,[52] the very case upon which the Government now relies. These findings were also approved by the Court below (279 F. 2d at pp. 156-7) (R. 46). Thereunder, the payment of cash, *per se*, has no effect upon accrual; and where, as here, a *bona fide* contest of the tax liability exists, the involuntary payment of the $15 is *not* an expense item but "is chargeable to a suspense, deferred debit or other receivable account", (Finding No. 38, Appendix III, p. 56, *infra*) and the accrual of any part of the $15 as an expense must await the outcome of the litigation. Thus, Respondent's position in the present case, that the legal principles of income tax accrual which this Court established in *Anderson* and *Dixie Pine*, place the emphasis upon the denial and contest of the liability, and not upon the involuntary payment during the contest, is in complete accord with the recognized accounting principles relevant to the accrual basis. It would go counter to the history and purpose of the federal income tax laws and to the declared intent of Congress and Treasury to create an unnecessary disparity between the two, as the Government seeks to do in the present case.

Administrative Considerations Support, Rather Than Militate Against, Congruency in the Present Case, of the Statutory Concept of Accrual With Recognized Accounting Principles

Since taxes are the "life blood" of Government,[54] one of the cardinal principles of tax administration is that the maximum revenue be determined and collected at the earliest point of time. To that end, the tax collector is interested

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[52] Appendix II, pp. 55-57, *infra*.

[54] *Bull* v. *United States*, 295 U. S. 247, 259.

in accelerating income and postponing deductions. Respondent's position accomplishes this purpose, whereas the Government's position would defeat it. The Government would accelerate, rather than postpone, deduction of the $15 and thereby forego immediate increased tax receipts. This attitude is reminiscent of the pre *Dixie Pine* days when, regardless of principle, the Commissioner took whatever position protected the revenue in a particular situation.[55] In addition to allowing a deduction for a tax liability which may not even exist,[56] it would also compel the Government to underwrite the future solvency of taxpayers by allowing them immediate deductions of contested local tax liabilities and then relying upon their restoration to income at some undetermined future date.[57]

The Government's contention (Br. 24) that payment is a "readily determinable" event upon which to predicate accrual ignores the fact that a *bona fide* contest of liability is an equally "readily determinable" event for that purpose. The contention also evades the real issue in this case; namely, which of these two events—the contest of the liability or the involuntary, compulsory payment—is to prevail under the income tax accrual concept defined by this Court (*Anderson, Dixie Pine, Security Mills* and *Lewyt*); and is but a repetition of the taxpayer's argument in *Dixie Pine* that the denial and contest of the asserted tax liability is not the critical event for purposes of accrual—an argument which this Court rejected (see pp. 14-17, *supra*).

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[55] The Commissioner's position in the present case is prompted by the fact that, because of the gradual increase in corporate income tax rates (normal plus surtax) from 38% in 1946 to 50¾% in 1951, it produces more revenue in this particular instance to have the deduction taken in 1946-1950 rather than in 1951.

[56] The administrative objections to this situation apply with equal force in the present case as they did to the disallowance of the deduction for interest on a contested tax liability, as outlined in *G. C. M. 9575*, X-1 C. B. 381, 383.

[57] The situation contemplated by Section 22(b)(12) to which the Government refers (Br. 31) is based upon the premise that the deduction was *properly* taken in the prior year. *Streckfus Steamers, Inc.*, 19 T. C. 1 (Acq. 1953-1 C. B. 6).

The Government advances as a further practical consideration the possibility of "calculated tax evasion" and manipulation by taxpayers of local tax controversies, quoting at length from the dissenting opinion below (Br. 25-26). This objection was fully answered by the Court below as follows (R. 47)[58]:

> "It is suggested in criticism of our decision that it leaves open to a taxpayer opportunities for manipulation through self-serving appraisals. Such opportunities are no greater when payment has been made under protest to prevent the attachment of liens or seizure, than when payment has not been made, as in the Dixie Pine case. The problem of determining whether the contest is a bona fide one is present in either situation. The criticism, we think is really directed against the Dixie Pine line of decisions."

Furthermore, with due respect, we submit that such an objection does not fully envisage the realities of the situation. Any "expedient" manipulation[59] to which the "great corporations" might resort, as charged by the Government and the dissenting Judge in the Court below, would redound to the benefit of the Government rather than to the corporations. By "postponing" the deductions, such "manipulating" taxpayers would be immediately out of pocket the resultant increase in tax (aggregating over $3¼ million in the present case) during the "indefinitely" postponed period (from 1 to 5 years in the present case) while the Government would have the use of that money, interest free. Is it reasonable to assume that such taxpayers would gamble that a future increase in tax rates[60]

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[58] *Consolidated Edison Company of New York* v. *United States*, 279 F. 2d 152, 157.

[59] Certainly, the unilateral payment of a contested tax liability during the contest, lends itself more readily to manipulation than does the bilateral settlement with the local tax authorities of a *bona fide* contest. In the present case the settlement of the contested real estate tax liabilities produced a refund of about $2½ million from the City of New York.

[60] What if the rates are reduced!

would exceed the resultant interest loss; or that a future net operating loss, after applying the carryback and carryforward loss provisions of the Code, would leave an unabsorbed portion in excess of the interest lost on the increase in tax originally paid?

The Commissioner's Administration of the Question Presented Herein Has Been Vacillating and Inconsistent. His Reliance Upon *G. C. M. 25298* Is a Bootstrap Attempt and Is Contrary to Its Subsequent Modification in *Mim. 6444*.

The Commissioner's reliance upon *G. C. M. 25298*, C. B., 1947-2, 39 in the present case is really an attempt to raise himself by his own bootstraps; for that was the very ruling issued to Respondent on the very question now before this Court.

The Commissioner had refused to accept or follow *Chestnut Securities*[61] until, some two years later, when he was confronted with Respondent's claims for refund for the years 1938, 1939, and 1941. Pursuing a revenue protection course, the Commissioner ignored *Chestnut Securities* with respect to the year 1938 and 1939 (and in the terms of the illustrative example, allowed $95 as a deduction), but seized upon *Chestnut Securities* to deny the 1941 claim for refund (with respect to the $5) and issued to Respondent the aforementioned ruling, which was later published as *G. C. M. 25298*. This ruling was just another step in the vacillating and inconsistent positions the Commissioner has taken on the question presented herein.[62] Respondent however, has consistently maintained its present position that contested items are non-accruable and non-deductible until the termination of the controversy, but was constrained to file its returns for 1946-1951 pursuant to the instructions of

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[61] Acceptance of an adverse court decision was, at that time, indicated by publishing it in the Cumulative Bulletin, or by a published G. C. M. or I. T. Nowadays, it is indicated by a published TIR or Rev. Rul.

[62] See pp. 8-9, *supra*, and Appendix III, pp. 58-61, *infra*.

the Commissioner addressed to it in the aforementioned ruling. The Government improperly implies (Br. 6, 7, fn. 1, 12) inconsistency on the part of Respondent because of this compliance.

Some two years later, the Commissioner modified *G. C. M. 25298,* and ruled that the payment of a contested tax "which is required as a prerequisite for further appeal", as distinguished from a payment to avoid penalties or interest,[63] was "not to be regarded as payment of a demanded tax deficiency". *Mim. 6444,* C. B. 1949-2, 11. The only apparent distinction between the two types of tax payments referred to in *Mim. 6444* is that one is a compulsory or involuntary payment and the other is a non-compulsory or voluntary payment.[64] Fundamentally, there is no difference between the compulsory payment to prevent the seizure and foreclosure of property under the New York law and the compulsory payment in *Mim. 6444.* In both situations an element of duress, is present. If, as a matter of law, payment *per se* is insufficient to accrue the contested tax liability in *Mim. 6444,* it is also insufficient to accrue the contested tax liability in the present case. Indeed the Government recognizes the conflict between the two rulings (Br. 30, fn. 14) but attempts to minimize it by claiming it was issued prior to the decision of the Court of Claims in the *Consolidated Edison* case, and also implies that the Commissioner overruled *Mim. 6444* by his acquiescense in *Lehigh Valley Railroad Co.,* 12 T. C. 977.

The fact that *Mim. 6444* was issued prior to the Court of Claims decision in the *Consolidated Edison* case (and

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[63] It should be observed that nothing is said about avoiding seizure and foreclosure of property.

[64] It has already been noted that under the New York law the involuntary payment of the $15 was a compulsory payment to avoid seizure and sale of property by foreclosure of the tax lien pending appeal to the State court from the adverse administrative ruling of the City Tax Commission. See p. 4, *supra.*

it is still outstanding) is merely additional proof of Respondent's statement (p. 15, *supra*) that the Commissioner often fails to follow his own ruling when it is in the interest of the revenue to do so.[65] And the reference to the Commissioner's acquiescence in *Lehigh Valley* is additional proof, if such be needed, that the Government has completely misread the *Lehigh Valley* case on this point. See discussion of that case at pp. 46-49, *infra*.

POINT III

The authorities upon which the Government relies are contrary to the principles of accrual established by this Court; and do not support the Government's contentions.

The Government relies primarily upon *Chestnut Securities Co.* v. *United States*, 104 C. Cls. 489, 62 F. Supp. 574; and *Consolidated Edison Co. of New York, Inc.* v. *United States*, 133 C. Cls. 376, 135 F. Supp. 881. These decisions, we submit, are contrary to the principles of accrual established by this Court; are themselves contradictory; and are also contrary to the decisions of other Courts on similar and related matters.

The Chestnut Securities Doctrine—"Accrual Does Not Survive Payment"

The theory that payment of an unadmitted and contested tax liability, in and of itself, accrues the liability, was first enunciated in *Chestnut Securities*. There, contested state taxes for the years 1936, 1937, and 1938 were held accruable and deductible, under Section 23(c), in 1940, the year they were paid, rather than in 1942, the year the contest was finally terminated. The taxpayer in

[65] The Commissioner, in *Lehigh Valley*, had also failed to follow his own ruling and the Tax Court made specific reference thereto. See fn. 2 at p. 998.

that case distinguished *Dixie Pine* on the ground that in *Dixie Pine* the tax had not been paid. Admitting that payment would have been controlling in the case of a cash basis taxpayer, the Government maintained that it was irrelevant in the case of an accrual basis taxpayer.

In answer thereto, the Court of Claims stated (104 C. Cls. at pp. 494-95):

> "We think the Government is wrong. One is not entitled to accrue a debt or other liability which is asserted against him but which he disputes and litigates, until the litigation is concluded. But if a liability is asserted against him and he pays it, though under protest, and though he promptly begins litigation to get the money back, the status of the liability is that it has been discharged by payment. It is hardly conceivable that a liability asserted against him, which he has discharged by payment, has not yet 'accrued' within the meaning of the tax laws and the terminology of accounting. *Accrual*, from the debtor's standpoint, *precedes payment, and does not survive it.*"

and after observing that in *Security Mills* the tax had not been paid,[66] continued:

> "In the instant case the taxpayer denied liability but paid. We think it thereby accrued the taxes and

[66] The Court, however, overlooked the fact that, under the Oklahoma law, the contested tax paid in *Chestnut Securities* was placed in a special account to await the outcome of the litigation, just as in *Security Mills* the contested tax was, under Court order, paid to a designated depository to await the outcome of the litigation. The Court of Claims may nevertheless have reached the correct result, because the decisions of this Court in *McGoldrick* v. *Berwind-White Coal Mining Co.*, 309 U. S. 33, 57-58 and *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435 which were followed by the District Court in 1940, in deciding that Chestnut Securities was liable for the contested state excise taxes, could well have been the basis for concluding that the taxpayer's subsequent appeals were merely pro forma and that the continued litigation was unwarranted and not *bona fide*.

> interest, *if accrual is requisite at all*, in the case of a debtor when actual payment has occurred."

The doctrine, "Accrual * * * precedes payment and does not survive it", was obviously based upon the court's belief that it was "within the meaning of the tax laws and the terminology of accounting"—beliefs which the Government completely ignores. Both of these beliefs were subsequently proven erroneous.

The phrase "if accrual is requisite at all", indicates that Court believed "paid or accrued", as used in Section 23(c), could be read in the alternative to permit an accrual basis taxpayer to take the deduction in the year of payment.[67] It was unnecessary to decide this question at that time since the same result was obtained under the doctrine that accrual does not survive payment. That belief, however, became the basis of the Court of Claim's decision in a later case[68] which was reversed by this Court. *United States* v. *Olympic Radio & Television, Inc.*, 349 U. S. 232.

The question whether the *Chestnut Securities* doctrine was "within the terminology of accounting" was squarely put in issue in the *Consolidated Edison* case filed in the Court of Claims. The specific findings of the Court of Claims thereon contradict *Chestnut Securities* and unequivocally hold that accrual *does* survive payment.[69]

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[67] In fact, *Chestnut Securities* was cited for this principle in a dictum in *Baltimore & O. R. Co.* v. *Magruder*, 77 F. Supp. 156, 169-170, cited by the Government (Br. 20). See discussion thereon at p. 50, *infra*.

[68] *Olympic Radio & Television, Inc.* v. *United States*, 124 C. Cls. 33, 110 F. Supp. 600.

[69] Findings numbered 35 to 38 inclusive, 133 C. Cls. 376, 397-98; and findings numbered 44, 45 and 46 with respect to the proper book entries in terms of the illustrative example. For convenience and ready reference, these findings are reproduced in Appendix III, pp. 58-61, *infra*.

The Court explained its failure to follow these findings because they "represent a refinement in ascertaining net income that would be impractical, and, in our opinion, infeasible in the administration of the revenue laws" (133 C. Cls. at p. 384).[70] No such claim was made by the Government nor was there anything in the record to even suggest it. And, of course, it is contrary to the intent of the accounting provisions of the Internal Revenue Code. See pp. 31-33, *supra*.

The "Otherwise Accruable" Doctrine Enunciated by the Court of Claims in the *Consolidated Edison* case.

The decision of this Court in *Olympic Radio*, reversing the Court of Claims decision that "paid or accrued" may be read in the alternative, was handed down just before reply briefs were due in the Court of Claims *Consolidated Edison* case. Confronted with this reversal and with its own findings that accrual *does* survive payment, the Court of Claims purported to adhere to *Chestnut Securities*,[71] but actually veered away from it, saying (*Idem* pp. 383-384):

> "What we have said does not mean that the mere payment of an item accrues that item * * *"

and then proceeded to expound an entirely new doctrine:

> "* * * but rather we hold that payment of an item which is *otherwise accruable in the taxable year* accrues the item even though payment is made under protest and even though litigation is started within the taxable year to obtain repayment."

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[70] The Court of Claims, itself, recognizes that questions of administrative impracticality in administering revenue laws are more properly matters for Congress to determine. *North American Van Lines* v. *United States*, 169 F. Supp. 252, 256.

[71] "In our opinion the rule stated in the *Chestnut Securities* case is applicable in the instant case." (133 C. Cls. at p. 381).

The court did not clarify whether "otherwise accruable" meant "otherwise accruable but for the payment" or "otherwise accruable but for the contest". Since *payment* was the crux of *Chestnut Securities*, upon which the Court relied, it is probable that it meant "otherwise accruable but for the payment". If so, the doctrine is clearly erroneous because, under *Dixie Pine*, the contested $15 was not accruable during the pendency of the litigation until it was completed in 1941 and, therefore, not "otherwise accruable" when the payment was made in 1939. If it meant "otherwise accruable but for the contest" the decision is contrary to *Chestnut Securities* where, but for the contest, the taxes would have accrued in 1936-1938, the years *for which* they were assessed, and not in 1940, the year the deduction was allowed;[72] and, of course, it ignores the basic and underlying concept of the contested liability test of *Dixie Pine*.[73]

The Court of Claims Decisions Are Contrary to the Decisions of Other Courts on This Question and on Related Matters

Less than a year after the Court of Claim's decision in the *Consolidated Edison* case, the question whether payment, *per se*, accrues an unadmitted and contested tax liability was, for the first time, passed upon by a court other than the Court of Claims in *Standard Oil Company* v. *United States*.[74] There, the taxpayer, while denying and contesting its liability for excise taxes on sales made in 1932 and 1933, paid the disputed taxes in 1937. The tax-

[72] In its Court of Claim's case, Consolidated Edison Company, emphasizing that payment is irrelevant for purposes of accrual, called the court's attention to the fact that if the Commissioner were correct and payment governed accrual, he should have allowed a deduction of the entire 1941-1942 City real estate tax instead of only the first half of the tax, because the Company had paid the entire tax in 1941, the second half of which was payable in 1942.

[73] See discussion at pp. 14-17, *supra*.

[74] 51 AFTR 1688; 56-2 USTC (CCH) Par. 10051.

payer finally lost the contest in 1947. The Government argued that, under the Court of Claims decisions in *Chestnut Securities* and *Consolidated Edison*, the taxpayer could take a deduction for the excise taxes only in 1937, the year of payment. After reviewing the *Dixie Pine*, *Security Mills*, *Chestnut Securities* and *Consolidated Edison* decisions, the District Court of Ohio held otherwise, saying:

> "This rule [of the Court of Claims] is not the same rule that was announced in the *Dixie Pine* case, though the court [of Claims] claims that it is."

and later concluded:

> "* * * the rule to be uniform should follow the straight rule laid down in *Dixie Pine* and *Security Flour* that all events do not occur within the taxable year that fix the amount and the fact of tax liability until litigation is ended. After all, payment is not really one of the events which fix the amount or the fact of tax liability, and the final adjudication is the last of those events."

The Government did not appeal that decision.

In the present case, the court below considered the Court of Claim's decisions in *Chestnut Securities* and *Consolidated Edison* in the light of the decisions of this Court in *Anderson, Dixie Pine, Security Mills,* and *Lewyt;* and in a well reasoned opinion concluded "with due respect we disagree with this view" of the Court of Claims that accrual precedes payment and does not survive it (R. 46). And more recently the 8th Circuit cited the decision of the Court below with approval as representing the converse, from the income viewpoint, of the principle which it decided in *Schlude* v. *Commissioner,* 283 F. 2d 234, 238, cert. applied for, January 4, 1961.

The Government's reference to the "claim of right" doctrine as supporting its position (Br. 23-24), ignores the fact that the doctrine is, among other things, a reve-

nue protecting departure from recognized accrual concepts —that a taxpayer, claiming and actually receiving the claimed income, should pay the tax thereon while it has the money to pay it rather than have the Government await the outcome of litigation *subsequently* commenced, or of an appeal subsequently taken, by one other than the taxpayer —by which time the taxpayer may have become insolvent and the tax uncollectible. The position of Respondent herein is supported by the equally cogent considerations and solicitude for the protection of the revenue which underlie the "claim of right" doctrine.[75] But more than that, it is the "disclaimer of right" doctrine—not the "claim of right" doctrine—that is analogous or the converse of the situation in the present case.

In *Sohio Corporation* v. *Commissioner*, 163 F. 2d 590, a purchaser of oil at the producer's well head was required, by State law, to collect the State tax imposed upon the producer by withholding it from the price and turning it over to the State less 2% for collecting the tax. The taxpayer sued to have the law declared unconstitutional. Meanwhile, as required by the statute, it withheld the tax on the oil it purchased and turned it over to the State less the 2%. In upholding the taxpayer's failure to report the 2% as income, the Court of Appeals for the District of Columbia stated (p. 593):

> "* * * we do not think that when a taxpayer is compelled by a state authority, over his protest, to retain possession temporarily of funds, he can be charged with having income on that account. The cases of Dixie Pine * * * and Security Flour * * *

[75] Although the "claim of right" doctrine falls within the broad category of income tax accrual, it is going pretty far afield to attempt to apply that doctrine to the "narrow issue" presented in this case. Moreover the most recent decision thereon does not support the Government's application of the claim of right doctrine. *Schlude* v. *Commissioner*, 283 F. 2d 234, cert. applied for January 4, 1961.

> dealt with deductions from income and held that a taxpayer may not accrue an expense the liability for which is contingent and is contested by the taxpayer. The problem in the present case concerns income rather than a deduction, but we think that the same principle applies. If, as a matter of law, a deduction is not accruable if the liability is contingent and contested by the taxpayer, similarly income is not accruable if the right thereto is contingent, being denied and contested by the taxpayer."

and:

> "We hold that where a taxpayer was compelled by a state law, under threat of heavy penalties and over its formal and repeated protest, to withhold from its vendors portions of its contract purchase price, and promptly contested in the courts the compulsory withholding, it had not received income by reason of this withholding."

See also *Bates Motor Transport Lines Inc.*, 17 T. C. 151, 158-59, aff. 200 F. 2d 20, 23-24 where the taxpayer failed in its proof as to the *amount* of the disclaimed receipts that were properly excludable from gross income.

The *Sohio* and *Bates* cases lend support to Respondent's position herein. Just as the denial of the right to the monies warrants their non-accrual, for income tax purposes, even though the monies were actually but involuntarily received, so does the denial and contest of asserted tax liabilities warrant their non-accrual, for income tax purposes, even though the liability was actually but involuntarily paid while denying and contesting the obligation therefor.

The Other Cases Cited By The Government Fail to Support Its Claim In The Present Case

Quoting from *Chestnut Securities* that accrual does not survive payment, the Government states (Br. 19) that "[t]he Tax Court has reached the same conclusion", and cites *Lehigh Valley R. R. Co.*, 12 T. C. 977; *Western Cart-*

ridge Co., 11 T. C. 246, 267-268; and also *Baltimore & O. R. Co. v. Magruder*, 77 F. Supp. 156, 169-170, aff'd 174 F. 2d 896. We respectfully submit that none of these cases called for the application of the *Chestnut Securities* doctrine, and that they fail to support the Government's contention.

In *Lehigh Valley* the Court summarized the complicated facts as follows (p. 995):

> "During the years 1932-1940, the State of New Jersey assessed in each year taxes on the petitioner's property located in that state. The petitioner paid in each of the years, before the due date, a portion of the taxes assessed for which it admitted liability [about 50% of the assessed tax], and contested in the courts the amount unpaid * * *
>
> "During the progress of the litigation, the petitioner paid additional amounts to the State of New Jersey in conformity with restraining orders of the United States District Court, requiring it to bring its payments on account of taxes up to a prescribed percentum of the tax originally imposed for the respective years. (At first the requirement was 50 per cent, this was later increased to 60 per cent, and finally to 70 per cent, of the tax originally assessed.) *Thereafter the amounts which were unpaid remained in controversy.*"

and (p. 999):

> "The record shows that the litigation as to the amounts of the taxes imposed for 1932-1933 which were unpaid and in controversy was terminated on April 17, 1939, * * * The litigation as to the amounts of the 1934-1936 taxes, unpaid and in controversy, was terminated April 28, 1941, * * * Thereafter, on August 4, 1941, the petitioner discontinued its appeals in the 1937-1940 cases."

The taxpayer urged that the final 30% of the unpaid and contested New Jersey taxes accrued and were deductible in the respective years the contests ended, 1939 and 1941; and that such deductions produced net operating

losses which, when carried forward to the following two years, wiped out the proposed deficiencies for those years. To avoid any confusion as to whether *Chestnut Securities* was or was not correct or applicable, counsel for taxpayer, in his opening statement specifically limited taxpayer's contention of non accrual to the final 30% of the asserted taxes, and conceded that 20% of the asserted taxes which were paid during the contests, accrued in the years paid, under *Chestnut Securities.*[76]

The Commissioner, pursuing a revenue protection course, maintained contrary to his own published ruling,[77] that the tax liabilities accrued in each of the earlier years *for* which they were assessed, because the contests were only of the *amounts* of the liabilities and not of the *fact* of liability; therefore, there were no available net operating loss deductions in 1941, 1942 and 1943 to wipe out the proposed deficiencies.

In deciding the issue before it—accrual of the 30% of the unpaid and contested taxes—the court said (p. 999):

> "In our judgment, the unpaid amount of the taxes imposed in each of the years 1932-1940, which was contested in the courts, was so contingent and uncertain as to make accrual improper until the termination or discontinuance of the litigation. We hold, therefore, that the amounts of 1932-1933 taxes which were unpaid and in litigation on January 1, 1939, accrued in 1939; that the amounts of the 1934-1936, and the 1937-1940 taxes which were unpaid and in

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[76] With respect to the deduction of the 20% in the years paid, counsel for the taxpayer said (p. 22 of transcript of testimony):

> "* * * we can get no benefit from it even though the contest was thereafter continued. We are willing in this case, in order to simplify the issues, to acquiesce in the doctrine of Chestnut Securities case, that payment is tantamount to an accrual, even though the contest be continued."

[77] The judge called specific attention to the fact that Commissioner's position was contrary to his own ruling. See fn. 2, p. 998.

litigation on January 1, 1941, accrued in 1941. *Lucas v. American Code Co., supra; Dixie Pine Products Co. v. Commissioner, supra; Security Flour Mills Co. v. Commissioner, supra.*"

and in connection with the concession made by the taxpayer's attorney regarding the 20% of the asserted tax paid during the contest, the court, in a dictum, continued (p. 999-1000):

> "We hold, further, that amounts of the unpaid and contested taxes which were paid from time to time during the progress of the litigation accrued and were deductible from gross income in the respective years when paid."

The acquiescence in *Lehigh Valley*, referred to by the Government (Br. 30, fn. 14), was in the decision of the Court on the issue before it—which the Government overlooks—and not in the above quoted dictum which the Government refers to and quotes in footnote 9 (Br. 19-20). The failure of the court to cite the *Chestnut Securities* case clearly indicates that the court itself was of the opinion that the *Chestnut Securities* doctrine was not in issue before it.

In *Western Cartridge*, the taxpayer's 1942 state income tax returns disclosed a tax liability of some $562,000 which it paid simultaneously with the filing of the return in 1943. It reserved the right to file an amended return when renegotiation of Government contracts were concluded. Upon conclusion of the renegotiation in 1944, the taxpayer filed an amended 1942 state tax return disclosing the resultant reduced income from the Government contracts and filed a refund claim of some $320,000 upon which no action had been taken by the time the Tax Court case was tried.

In its 1942 federal income tax return, the taxpayer took a deduction for state income taxes of about $572,000 which the Commissioner allowed. The Commissioner then sought to relate back to 1942 the result of the renegotiation agree-

ment and reduce the state income tax deduction by some $318,000, which the Tax Court overruled. This ruling does not involve the application of the *Chestnut Securities* doctrine that payment accrues a contested liability; it merely presents an *Anderson* situation where a taxpayer, by self assessment, pays a 1942 uncontested tax liability when due in 1943. Had the Tax Court applied the doctrine that payment accrues a contested liability, it would have had to allow the state tax deduction of the state taxes in 1943, the year they were paid, instead of allowing the deduction in 1942.

In the *Baltimore & Ohio* case, the taxpayer, on the accrual basis, did not pay the tax imposed by the Carrier's Taxing Act and sued to have the Act declared unconstitutional. The District Court, following *Dixie Pine*, upheld the Commissioner's disallowance of the taxpayer's deduction of those taxes. In distinguishing that case from those where other railroads contested but paid the Carrier's tax, the Court, citing *Chestnut Securities*, stated (77 F. Supp. at pp. 169-170) that those other railroads "are in an entirely different situation, because having actually paid the tax, the amount so paid undoubtedly constitutes 'taxes paid • • • within the taxable year' as provided in section 23(c) • • • and, therefore, the question of whether a deduction for taxes has 'accrued' within the meaning of that section is not involved." This statement, upon which the Government relies, in addition to being dictum, cites *Chestnut Securities*, not for the proposition that accrual does not survive payment, but for the proposition that section 23(c) is to be construed in the alternative to permit a taxpayer to take a deduction either for taxes paid or taxes accrued, a construction rejected by this Court in *Olympic Radio*. See discussion thereon at pp. 40-41, *supra*.

POINT IV

The right to a refund of part of a contested and involuntarily paid tax, as determined by a later settlement of the contest, does not constitute income in the year of settlement.

It follows, from Respondent's argument in Point I, that its right to the refund of the $5, established by the settlement in 1951, did not constitute taxable income in 1951[78]. The payment of the $15 was a balance sheet transaction which had no income tax consequence and which was held in suspense, for income tax purposes, pending the outcome of the contest proceedings. The return of the $5 was a reversal, to that extent, of that transaction—and similarly had no income tax consequence.

The fact that Respondent was improperly allowed a deduction in 1949 of the contested $15, of which the $5 was a part, does not warrant taxing as income the $5 refund in 1951. Under the annual accounting system of our income tax laws, each year is separate and independent, and stands on its own feet. If an error is committed with respect to a taxpayer's income tax liability for a year that is closed by the statute of limitations, it may not be rectified by adjusting that taxpayer's income tax liability for another year. Congress has expressed its intent "to require re-

[78] The Government's argument in Point II of its brief (Br. 30-31) that the $5 constitutes taxable income in 1951 is similarly based on the assumption that it is correct in its argument that the $15 accrued and was *properly* deductible under Section 23(c) in 1949. In *Rothensies* v. *Electric Storage Battery Co.*, 329 U. S. 296, cited by the Government, the taxpayer admitted, and had not contested, its liability for the excise taxes; and had *properly* accrued and deducted them in the year of assessment. The subsequent refund of that tax was therefore includable in gross income because it was a refund of an item which had been *properly* deducted in a prior year. This, too, is the underlying basis of the tax benefit rule embodied in Section 22(b)(12).

fund to the taxpayer of an overpayment, even though he has failed to pay taxes for other periods, whenever their collection is barred by limitation". *McEachern* v. *Rose*, 302 U. S. 56, 62. Respondent, having overpaid its 1951 income tax by erroneously including the $5 in its income, is entitled to its refund regardless of the fact that $15 (of which the $5 was part) was erroneously allowed as a deduction in Respondent's return for 1949 which is now closed by the statute of limitations. *Commissioner* v. *Dwyer*, 203 F. 2d 522, 524-525; *Streckfus Steamers, Inc.*, 19 T. C. 1.

Any relief or remedy available to the Commissioner with respect to Respondent's $15 deduction in 1949, in the event of a decision in Respondent's favor in the present case, is specifically provided in Sections 1311-1315 of the Internal Revenue Code of 1954. Thereunder, the statute of limitations for the year 1949 is opened up for one year after a decision herein in favor of Respondent becomes final, within which the Commissioner may assert a deficiency for 1949, with respect to the $15 in accordance with the provisions in said Sections 1311-1315.

POINT V

The decision and judgment of the Court below should be affirmed.

Respectfully submitted,

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APPENDIX I

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * *

(c) *Taxes generally.*—

(1) Allowance in general—Taxes paid or accrued within the taxable year, * * * [with exceptions not material here].

* * *

(26 U. S. C. 1952 ed., Sec. 23)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income.

* * *

(26 U. S. C. 1952 ed., Sec. 41)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable years in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period.

* * *

(26 U. S. C. 1952 ed., Sec. 42)

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the dividends paid credit provided in section 27) provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

* * *

(26 U. S. C. 1952 ed., Sec. 43)

SEC. 48. DEFINITIONS.

When used in this title——

* * *

(c) *Paid, Incurred, Accrued.*—The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

* * *

(26 U. S. C. 1952 ed., Sec. 48)

APPENDIX II

Findings with respect to the applicable accounting principles in Consolidated Edison Company of New York v. United States, 133 Ct. Cls. 376, 397-398 and 400-401.

35. The accrual method of accounting as recognized by well-established principles of accounting is fundamentally different from the cash basis of accounting. Under a strict cash basis, transactions and events are not recorded until cash has been received or paid, without regard to the period to which they relate or the period in which the revenues or expenses apply. The accrual method, however, is based upon the principle of recording transactions and events as they occur, regardless of when the cash receipts and disbursements part of the activities takes place. Revenues are accrued as nearly as practicable to the period earned, and expenses, which include taxes, are accrued and allocated in as reasonable and consistent a manner as possible in the period and against the revenues they helped to produce. The primary purpose of accrual accounting principles is to obtain a proper and fair determination of periodic income, often referred to as the process of matching costs against revenues, so that in each accounting period there will be deducted all the ascertainable costs necessary to produce the revenue, including indirect period costs such as depreciation, taxes and interest.

36. Under the accrual method of accounting, the payment of cash extinguishes a liability that either has already been recorded for purposes of determining income or is yet to be recorded for purposes of determining income, but it does not of itself have any effect upon the determination of income. It may either precede or survive the accrual or recordation and is a balance sheet transaction which reduces the cash asset and is balanced by a corresponding reduction of a liability or the substitution of another asset in its place, but it has no effect on the profit or loss—the income determination.

37. When the term "accrual" is used in a balance sheet sense, as distinguished from an income-determining sense, it could never survive payment because payment extinguishes the liability and eliminates it from the balance sheet. But in an income-determining sense, payment has no effect upon accrual which may or may not survive payment depending upon whether the payment is in extinguishment of a liability already accrued or in prepayment of a liability to be incurred, determined, or accounted for at a later date or period.

38. Under accrual accounting, when payment is made with respect to a liability which is denied in whole or in part, the accounting principle as to charges against income would be the same as if payment had not been made; such payment would not affect the treatment of any accruals. This principle applies equally to the payment of taxes. The payment of the admitted or estimated ultimate liability constitutes the payment of a current charge or expense of operations and the balance of that payment represents an amount estimated to be ultimately recovered and is chargeable to a suspense, deferred debit, or other receivable account. The latter item represents an asset—a deposit which is expected to be recovered.

* * *

44. The proper book entries of this example, according to well-recognized and sound principles of accrual accounting, and in accordance with the Uniform Systems of Accounts prescribed by the P. S. C. are illustrated by the following set of entries:

1939

(1)	Dr. Tax expense	$85.00	
	Cr. Taxes accrued		$ 85.00
	(To record the admitted liability for taxes for the year 1939)		
(2)	Dr. Taxes accrued	85.00	
	Deposit for contested taxes	15.00	
	Cr. Cash		100.00
	(To record payment of the assessed tax, part of which is contested)		

	1941		
(3) Dr. Cash		5.00	
Tax expense		10.00	
Cr. Deposit for contested taxes			15.00
(To record final settlement of the contested taxes.)			

45. Under the generally accepted and well-recognized principles of accrual accounting, the $15 in this example, which the plaintiff paid over and above its admittedly liability of $85 for taxes in 1939, and which in the best judgment of management would be recovered as soon as full legal proceedings were consummated, would constitute an asset until August 1941 when the settlement was made, and when for the first time the plaintiff had knowledge that instead of an asset of $15 it had only an asset of $5, and that the remaining $10 was, instead, an expense.

46. Under these accrual accounting principles, the $10 expense is accrued and deducted in 1941 and is not related back to 1939 because accrual accounting principles are based, among other things, upon reasonableness and practicability. Under accrual accounting it would be considered unreasonable and impractical to go back and reopen closed years, the income of which had been determined upon an appraisal of all facts then known. Subsequent developments are taken into consideration and recorded in the year when they occur. If they occur immediately after the end of the year involved and before the books for that year are closed (it usually takes about 30 days to close the books of a substantial business that are kept on an accrual basis), the same practical approach would prompt taking those events into account in the prior year—but aside from this exception, under accrual accounting principles, the facts and developments are recorded in the year they occur.

APPENDIX III

Chronology of published rulings reflecting the changes in Commissioner's official position with respect to the income tax treatment of contested tax liabilities.

1920—*O. D. 741*, C. B. 3, 15—import duties erroneously paid in 1915-1917 and refunded in 1919, are not taxable in 1919, but were improperly deducted in 1915-1917.

1926—*S. M. 4683*, C. B. V-1, 59—an unconstitutional State tax law is a nullity; payments thereunder are not deductible.

1931—*I. T. 2578*, C. B. X-1, 119—a State tax law declared unconstitutional by the State Court is a nullity. A payment thereunder is not deductible for Federal income tax purposes even though Federal Court has not passed on its constitutionality. Refund of said erroneously paid tax is not taxable income.

1931—*G. C. M. 9575*, C. B. X-1, 381—interest on a contested tax liability does not accrue during the contest.

1931—*G. C. M. 9774*, C. B. X-2, 137—State franchise taxes accrue in the year in which the income, on which they are based, is earned and not in the year in which they become due and payable.

1932—*Mim. 3958*, C. B. XI-2, 33—under *O. D. 741* refund of an improperly paid tax is not income; but if a properly paid tax is refunded because of a subsequent event, the refund is taxable.

1933—*I. T. 2741*, C. B. XII-2, 48—a State tax law requiring spouses, filing separate returns, to compute their State tax liability on their combined income was declared unconstitutional. Each spouse is entitled to a deduction, for Federal income tax purposes, only in the amount of State tax properly due on their respective incomes; but where the State permitted to remain unchanged the reduced tax resulting from the

losses of one spouse offsetting the income of the other, only the amount of the tax actually paid the State is deductible.

1935—*I. T. 2934*, C. B. XIV-2, 63—under *I. T. 2578*, accrual of liability to the railroad retirement fund under an Act which was declared unconstitutional, is not allowable.

1935—*I. T. 2935*, C. B. XIV-2, 91—State franchise taxes accrue in the year in which the income, on which they are based, is earned and not in the year in which they become due and payable.

1937—*I. T. 3086*, C. B. 1937-1, 77—the practice to disallow deduction of unpaid AAA taxes, later declared unconstitutional, and to allow their deduction if paid, will be continued.

1937—*Mim. 4564*—C. B. 1937-1, 93—refund of illegally collected custom duties deducted in prior year now closed by statute of limitations, is taxable as income in the year of refund. *Mim. 3958* and other such rulings are modified.

1938—*I. T. 3170*, C. B. 1938-1, 135—deduction of paid AAA taxes will be disallowed if taxpayer files a refund claim under Title VII of 1936 Act.

1941—*I. T. 3491*, C. B. 1941-2, 177—regardless of the delay in its determination, a contested tax liability accrues and is deductible in the year for which it is imposed, but the interest thereon accrues and is deductible in the year the contest ends.

1942—*I. T. 3563*, C. B. 1942-2, 115—disputed back wages due under Fair Labor Standards Act accrue in year the services were rendered, and not in the year they were determined and paid.

1944—*Dixie Pine Products Co.* v. *U. S.*, 320 U. S. 516, published in C. B. 1944, 509—a contested tax liability

does not accrue and is not deductible during the contest.

1944—*Security Flour Mills Co.* v. *Com'r*, 321 U. S. 281, published in C. B. 1944, 526—refund of part of purchase price received on a sale in an earlier year may not be related back to the year of sale.

1944—*Stanard-Tilton Milling Co.*, 3 T. C. 1026 (Issue #2), N. A., C. B. 1944, 48—refund of uncontested AAA taxes, accrued in earlier year, may not be related back to the earlier year.

1945—*I. T. 3746*, C. B. 1945, 141—disputed back wages due under Fair Labor Standards Act accrue in year the liability is finally determined. *I. T. 3563* is modified.

1947—*G. C. M. 25298*, C. B. 1947-2, 39—a contested tax liability accrues not later than time of payment, notwithstanding continuation of contest. The accrual basis of accounting relates to the deductibility of unpaid items.

1947—*I. T. 3863*, C. B. 1947-2, 141—revokes *I. T. 3491* on basis of *G. C. M. 25298*.

1949—*Stanard-Tilton* nonacquiescence withdrawn—decision acquiesced in C. B. 1949-1, 3.

1949—*Mim. 6444*, 1949-2, 11—payment of contested tax liability as a prerequisite for appeal is not deductible under *G. C. M. 25298*. A proper deduction of a tax is not affected by its subsequent invalidation, regardless of whether it was legally or illegally imposed; and the refund thereof constitutes income to the extent the prior deduction resulted in a tax benefit, unless otherwise provided by statute. This does not apply to refund of State income taxes resulting from renegotiation of Government contracts Sec. 3806). *O. D. 741* is revoked; and *Mim. 3598*, *Mim. 4564*, *I. T. 2578*, *I. T. 2741*, and *I. T. 2934* are accordingly modified.

1950—*I. T. 3999*, C. B. 1950-1, 129—revokes *I. T. 3170* on basis of *G. C. M. 25298* and *Mim. 6444*.

1950—1950-2 C. B. 4—acquiescence in *Western Cartridge Co.*, 11 T. C. 246 (1948) and *Taylor Instrument Companies*, 14 T. C. 388 (1950) holding that deductions for State taxes taken on basis of excessive profits on Government contracts which were subsequently renegotiated and profits reduced, are not to be revised by relating back the reduced profits on the Government contracts.

1951—*Mim. 6597*, C. B. 1951-1, 20—exception in *Mim. 6444* regarding revision of State taxes resulting from renegotiated Government contracts is eliminated on basis of *Western Cartridge* and *Taylor Instrument* decisions.

1953—*Rev. Rul.* 6, C. B. 1953-1, 120—on the basis of *Mim. 6444*, the adjustment of taxes paid or accrued, which is required in computing Section 102 income, is not affected by the reduction of tax liability for the year involved which results from the carryback of an operating loss of a subsequent year.

1957—*Rev. Rul. 57-105*, C. B. 1957-1, 193—in amplification of *G. C. M. 25298*, the filing of a State tax return constitutes a denial of liability for State taxes in excess of the amount shown to be due on the return. A State tax deficiency does not accrue until the amount thereof is determined by litigation or default or admission of liability therefor.

SUPREME COURT OF THE UNITED STATES

No. 357.—October Term, 1960.

United States, Petitioner, v. Consolidated Edison Company of New York, Inc.	On Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

[May 22, 1961.]

Mr. Justice Whittaker delivered the opinion of the Court.

Respondent brought this action in the United States District Court for the Southern District of New York to recover a claimed overpayment of federal income taxes for the year 1951. It keeps its books and files its returns on a calendar year-accrual basis. The case turns on the correct determination of the proper year of accrual and deduction of certain contested real estate taxes. Specifically, the question is whether the contested part of a real estate tax *accrued* (1) in the year it was assessed and, for the purpose—and as the only mode recognized by the local law—of avoiding seizure and sale of the property for the contested tax while the contest was pending, was "paid" by the taxpayer, or (2) in the year the contest was finally determined.

The District Court, following the holding of the Court of Claims in *Consolidated Edison Co.* v. *United States*, 133 Ct. Cl. 376, that such a "payment" of the tax "accrues the item even though payment is made under protest and even though litigation is started within the taxable year to obtain repayment," *id.*, at 383–384, held, without opinion, that the contested part of the tax accrued in the year of the "payment." On appeal, the Court of Appeals, by a divided court, held that the contested part of the tax accrued in the year the contest was finally deter-

mined, and reversed the judgment. 279 F. 2d 152. It reasoned that inasmuch as respondent was "keeping its books on the accrual basis," the contested part of the tax accrued "only when all events [had] occurred which determine[d] the fact and amount of the tax liability." *Id.*, at 155. To resolve the conflict between the decision below and *Consolidated Edison Co.* v. *United States*, *supra*, we granted certiorari. 364 U. S. 890.

During the years involved—1946 through 1950—respondent owned numerous tracts of real estate in New York City which were subject to annual local property taxes. Under the New York law, the City Council annually fixes the tax rate, and the City Tax Commission annually fixes the property valuations. Thus the amount of the tax on each tract is determined by multiplying the valuation by the tax rate. The tax rate is not contestable, but a timely application (commonly called a "protest") may be made to the City Tax Commission to correct an erroneous valuation. Among other things, the protest must state the amount which the taxpayer "consider[s] was the full value of the property on January 25 [of the current] year" thus to establish the amount of the tax that is not contested. Upon exhaustion of this administrative procedure, a review of the Commission's determination may be had by a judicial proceeding, commonly called a certiorari proceeding, in the State Supreme Court, which is the taxpayer's sole and exclusive remedy. But the institution of such a suit does not stay or suspend the maturity of the tax bill, the accrual of 7% interest on it, nor the seizure and sale of the property to satisfy the tax lien. Thus, to obtain review, the taxpayer must either "pay" the tax or suffer the interest penalty and run the risk of seizure and sale of its property.[1]

[1] The procedures allowed by the laws of New York for the contest of real property taxes are more fully set forth in *Consolidated Edison Co.* v. *United States*, 133 Ct. Cl. 376, 378.

Though taxes for each of five years on hundreds of tracts are involved and the aggregate amount is very substantial, the parties very commendably stipulated in the District Court that the facts are sufficiently reflected, for the purposes of this suit, in the following simplified example:

In each of the years 1946 through 1950, respondent was notified of a tentative valuation which, at the established tax rate, would produce a tax of $100. Respondent then timely filed a *bona fide* protest (in respect of many, but not nearly all, of its tracts) stating a valuation which, at the established tax rate, would produce a tax of $85, and asking that the balance of the proposed valuation be stricken as excessive. After hearing, the Commission rejected the protest, and an assessment in the amount of $100 was made. Thereupon respondent, under protest and for the honestly stated purpose of avoiding the interest penalty and the seizure and sale of its property while it was contesting the Commission's valuation by certiorari proceedings in the state court, remitted to the city cash in an amount equal to the tax of $100, and immediately thereafter commenced a certiorari proceeding in the proper court, in which it again admitted liability for a tax in the amount of $85, but denied all liability for any tax in excess of that amount. In December 1951, the court, upon the consent of the parties to the action, entered its order in (each of) the certiorari proceedings fixing respondent's tax liability at $95, and thereupon the city forthwith returned $5 to respondent.

Although it was then engaged in a contest with the Commissioner in the Court of Claims over an identical question, namely, the proper income tax treatment to be accorded the $15 for each of the years 1938, 1939 and 1941—which issue was decided by the Court of Claims in December 1955 in favor of the Government, *Consolidated Edison Co.* v. *United States, supra*—respondent, in

terms of the illustrative example, accrued on its books and deducted on its federal income tax returns, for each of the years 1946 through 1950, the full $100; and in its return for the year 1951—in which year the real estate tax liability was determined to be $95—respondent failed to deduct the $10 from, and included the $5 in, its gross income for that year.[2]

Believing that this treatment of the $15 in 1951 was erroneous and resulted in its paying a lesser amount of federal income taxes in each of the years 1946 through 1950, and more in the year 1951, than it should have paid,[3] respondent filed in February 1955 its claim for refund of so much of its 1951 income taxes as resulted (1) from its failure to deduct the $10 of real estate tax that was determined, in that year, to be valid, and (2) from its inclusion in gross income of the $5 returned to it in that year. Upon rejection of that claim, respondent timely brought this action in the District Court to recover the refund claimed, and obtained the result already stated.

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[2] Respondent asserts that this treatment of the $15 in its 1951 federal income tax return was made under cumpulsion of the Commissioner's erroneous G. C. M. 25298, issued directly to it in 1947 (C. B. 1947-2, 39), saying, "a contested tax liability accrues not later than time of payment, notwithstanding continuation of contest. The accrual basis of accounting relates to the deductibility of unpaid items," and that the Commissioner insisted upon that treatment, despite his modification thereof in *Mim.* 6444 (C. B. 1949-2, 11), saying in pertinent part, that "payment of [a] contested tax liability as a prerequisite for appeal is not deductible under G. C. M. 25298."

[3] The economic consequences to the parties arise from the fact that corporate income tax rates (normal plus surtax) were increased from 38% in 1946 to 50¾% in 1951, and, in this particular instance, more revenue would be produced by taking the deduction in 1946–1950 than in 1951. The taxpayer recognizes that, if its position be sustained, the Commissioner will have one year after entry of final judgment herein to reaudit the taxpayer's 1946–1950 returns and to assess deficiencies based upon deduction of the $15 in those years, in accordance with the provisions of §§ 1311–1315 of the Internal Revenue Code of 1954.

It is settled that each "taxable year" must be treated as a separate unit, and all items of gross income and deduction must be reflected in terms of their posture at the close of such year. *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359; *Heiner* v. *Mellon*, 304 U. S. 271; *Guaranty Trust Co.* v. *Commissioner*, 303 U. S. 493; *Security Mills Co.* v. *Commissioner*, 321 U. S. 281. And the parties agree that, under the applicable federal statutes,[4] neither the Government nor an accrual-basis taxpayer may cause an item to be deducted in a year other than the one in which it accrued. *United States* v. *Anderson*, 269 U. S. 422; *Security Mills Co.* v. *Commissioner*, *supra*; *United States* v. *Olympic Radio & Television*, 349 U. S. 232. They also agree that the "touchstone" for determining the year in which an item of deduction accrues is the "all events" test established by this Court in *United States* v. *Anderson*, *supra*,[5] and since reaffirmed by this Court on numerous occasions, so that it is now a fundamental principle of tax accounting. See, *e. g.*, *Lucas* v. *American Code Co.*, 280 U. S. 445; *Brown* v. *Helvering*, 291 U. S.

[4] The applicable statutes are §§ 23 (c), 41, 42, 43 and 48 of the Internal Revenue Code of 1939 (26 U. S. C. (1952 ed.), §§ 23 (c), 41, 42, 43, 48). These provisions are the same as their counterparts in prior Revenue Acts and in the Internal Revenue Code of 1954. Inasmuch as those statutes are not really in contest in this case, it would serve no useful purpose even to abstract them here.

[5] In the *Anderson* case this Court declared the so-called "all events" test as follows: "In a technical legal sense it may be argued that a tax does not accrue until it has been assessed and becomes due; but it is also true that in advance of the assessment of a tax, all the events may occur which fix the amount of the tax and determine the liability of the taxpayer to pay it. In this respect, for purposes of accounting and of ascertaining true income for a given accounting period, the munitions tax here in question did not stand on a different footing than other accrued expenses appearing on appellee's books. In the economic and bookkeeping sense with which the statute and Treasury decision were concerned, the taxes had accrued." 269 U. S., at 441.

193; *Dixie Pine Co.* v. *Commissioner*, 320 U. S. 516; *Security Mills Co.* v. *Commissioner, supra.*[6] The parties also recognize that this Court amplified, or as the Government says "added a refinement to," the "all events" test by its holding, in *Dixie Pine Co.* v. *Commissioner, supra*, that an accrual-basis taxpayer could not, while "contesting liability in the courts," deduct "the amount of the tax, on the theory that the state's exaction constituted a fixed and certain liability," but "must, in the circumstances, await the event of the state court litigation and might claim a deduction only for the taxable year in which its liability for the tax was finally adjudicated." 320 U. S., at 519. That principle was specifically reaffirmed in *Security Mills Co.* v. *Commissioner, supra.*[7]

That $85 of the $100 assessment was admitted to be owing and was intended to be paid and satisfied by the remittance, and thus accrued in the year of the remittance, is not in dispute. Respondent's good faith, in contesting $15 of the assessment, is not in dispute, for the

[6] In the *Dixie Pine* case, this Court reaffirmed the "all events" test as follows: "It has long been held that in order truly to reflect the income of a given year, all the events must occur in that year which fix the amount and the fact of the taxpayer's liability for items of indebtedness deducted though not paid; and this cannot be the case where the liability is contingent and is contested by the taxpayer." 320 U. S., at 519.

In the *Security Mills* case, this Court reaffirmed that test as follows: "It is settled by many decisions that a taxpayer may not accrue an expense the amount of which is unsettled or the liability for which is contingent, and this principle is fully applicable to a tax, liability for which the taxpayer denies, and payment whereof he is contesting." 321 U. S., at 284.

[7] In the *Security Mills* case, after saying "that a taxpayer may not accrue an expense the amount of which is unsettled or the liability for which is contingent," the Court concluded that "[s]ince [the taxpayer] denied liability for, and failed to pay, the tax during the taxable year 1935, it was not in a position in its tax accounting to treat the [tax] claim as an accrued liability." 321 U. S., at 284.

Government expressly "disavow[s] any suggestion that the respondent . . . filed its claims against the City of New York in bad faith, . . . calculatingly inflated those claims, or . . . failed to prosecute them with diligence." Nor is it questioned that accrual of such taxes in the proper year accords with "good accounting" principles.

But concordance of the views of the parties ends at this point. The Government contends that the remittance by respondent to the city, in each of the years in question, of cash in an amount equal to the whole of the assessed tax admitted liability for, and was intended to and did constitute "payment" and "satisfaction" of, both the disputed and undisputed parts of the assessment; and that when "the taxpayer pays the item and thereby discharges its liability, the expense has been incurred and there is no longer any contingency which would prevent its accrual." Respondent, on the other hand, insists that its remittance to the city was not intended to and did not admit liability for, nor constitute "payment" and "satisfaction" of, the contested $15 of the assessment, but was, in effect, a mere deposit, in the nature of a cash bond, required of respondent, in a practical sense, by the local law as the only available mode of avoiding the risk of seizure and sale of the property for the contested tax while its validity was being diligently contested in the only way allowed by the laws of the State.

Thus the very narrow issue here is whether the remittance admitted liability for, and constituted "payment" and "satisfaction" of, the contested part of the assessment and thereby rendered it accruable in the year of the remittance. Like the Court of Appeals, we think the respondent is right in its contention, and that $10 of the contested $15 of the tax accrued when liability in that amount was finally determined by the New York court in 1951, and that the $5, for which respondent was by

that judgment held not liable, and which was returned to it by the city, was not income to respondent in 1951.

Although the Government attempts to distinguish the *Anderson, Dixie Pine* and *Security Mills* cases on the ground that "payment" of the contested taxes had not been made in those cases, it primarily relies on the decisions of the Court of Claims in *Chestnut Securities Co.* v. *United States*, 104 Ct. Cl. 489 and *Consolidated Edison Co.* v. *United States*, 133 Ct. Cl. 376.

The *Chestnut Securities* case turned on the question whether certain judicially contested state income taxes (for the years 1936–1938) accrued when they were paid in 1940, as claimed by the accrual-basis taxpayer, or when the final judgment upholding their validity was rendered in 1942, as contended by the Government. Squarely contrary to its contention here, the Government, relying on *Security Mills Co.* v. *Commissioner, supra*, there contended that "since the [taxpayer's] accounts were kept and its tax returns made on the accrual basis, it could not take its deduction for the taxes . . . paid to the State . . . until the year 1942, when its suit for their return was finally decided adversely to it." On the facts of that case, the Court of Claims held that "the Government [was] wrong" in that contention. Although, in full consonance with the *Security Mills* case, the Court of Claims said "[o]ne is not entitled to accrue a debt or other liability which is asserted against him but which he disputes and litigates, until the litigation is concluded," it went on to say "[b]ut if a liability is asserted against him and he pays it, though under protest, and though he promptly begins litigation to get the money back, the status of the liability is that it has been discharged by payment. It is hardly conceivable that a liability asserted against him, which he has discharged by payment, has not yet 'accrued' within the meaning of the tax laws and the terminology of accounting. Accrual.

from the debtor's standpoint, precedes payment, and does not survive it." 104 Ct. Cl., at 494–495. And after pointing to this Court's use of the phrase "and failed to pay" in its holding in the *Security Mills* case that "Since [the taxpayer] denied liability for, and failed to pay, the tax during the taxable year 1935, it was not in a position in its tax accounting to treat the Government's claim as an accrued liability," the Court of Claims concluded: "In the instant case the taxpayer denied liability, but paid. We think it thereby 'accrued' the taxes and interest, if accrual is requisite at all, in the case of the debtor, when actual payment has occurred." 104 Ct. Cl., at 495.

The *Consolidated Edison* case involved the same parties, facts and questions as the present case, though in respect to earlier tax years. Although recognizing that this Court's opinions in *Security Mills Co.* v. *Commissioner, supra,* and *Dixie Pine Products Co.* v. *Commissioner, supra,* had "settled" the law to be "that a taxpayer may not accrue an expense when he is denying liability and refusing and contesting its payment," the Court of Claims rejected, as "not necessarily true," the taxpayer's argument "that there must therefore be an admission or absence of denial of liability before an item may be accrued, and that the payment of the liability within the taxable year has no effect on its accrual since payment was made under protest and litigation was immediately started to obtain a repayment" (133 Ct. Cl., at 382); and, purporting to follow, but seemingly departing from, its decision in the *Chestnut Securities* case, the Court concluded "that payment of an item *which is otherwise accruable in the taxable year* accrues the item even though payment is made under protest and even though litigation is started within the taxable year to obtain repayment." 133 Ct. Cl., at 383–384. (Emphasis

added.) On that conclusion the Court rendered judgment for the Government.

Just what the Court meant by the phrase we have italicized was not explained, but it is evident that if the tax item was "otherwise accruable in the taxable year," payment—whether of a character that would constitute an admission of the asserted liability or a mere deposit to enable contest of the liability—certainly would not render the item non-accruable; and if, in the absence of payment, the item was "otherwise accruable in the taxable year," payment would be immaterial, or at least unnecessary, to the question of accruability. It thus appears that the Court's judgment was contrary to its rule in that case, for, although it regarded the remittance as "payment" of the asserted tax liability, admittedly the contested part of the tax was not "*otherwise* accruable in the taxable year."

Disagreeing with the conclusion of the Court of Claims in the *Consolidated Edison* case, the Court of Appeals concluded, we think correctly, that the question of accruability of the tax—apart from the issue respecting "payment" and "satisfaction"—was governed by the "all events" test established by this Court in *United States* v. *Anderson*, *supra* (see note 5), as amplified and affirmed in *Dixie Pine Co.* v. *Commissioner*, *supra*, and reaffirmed as amplified in *Security Mills Co.* v. *Commissioner*, *supra*. See notes 6 and 7.

As to whether respondent's remittance of the full $100 to the city, in the circumstances of this case, constituted an admission of liability for, and a "payment" and "satisfaction" of, the contested $15 of the assessment, the Court of Appeals recognized that this Court's opinions in the *Anderson*, *Dixie Pine* and *Security Mills* cases refer to the fact that "payment" of the taxes sought to be deducted in those cases had not been made by the taxpayers, but it thought, and we agree, that those references

were made only for the sake of complete accuracy to an important but, so far as those cases were concerned, a collateral matter, and not to the determinative considerations of those cases, which were the "all events" test as they state it.

"Payment" is not a talismanic word. It may have many meanings depending on the sense and context in which it is used. As correctly observed by the Court of Appeals, "A payment may constitute a capital expenditure, an exchange of assets, a prepaid expense, *a deposit*, or a current expense," and "[w]hen the exact nature of the payment is not immediately ascertainable because it depends on some future event, such as the outcome of litigation, its treatment for income tax purposes must await that event." 299 F. 2d, at 156. (Emphasis added.)

Of course, an unconditional "payment" made by a taxpayer in apparent "satisfaction" of an asserted matured tax liability is, without more, plain and persuasive evidence, at least against the taxpayer, that "all the events [have] occur[red] which fixed the amount of the tax and determine the liability of the taxpayer to pay it," *United States* v. *Anderson, supra*, at 441, and that the item so paid and satisfied has accrued.

But where, as stipulated by the parties in this case, the remittance or "payment" did not admit, but specifically denied, liability for, and was not intended to satisfy, the contested $15 of the assessment, but was, in effect, a mere deposit, "in the nature of a cash bond for the payment of [so much, if any, of the contested] taxes [as might] thereafter be found to be due" (*Rosenman* v. *United States*, 323 U. S. 658, 662, and see *Lewyt Corp* v. *Commissioner*, 215 F. 2d 518, 523 (C. A. 2d Cir.)), and was made for the sole purpose of staying—there being no other way to stay—an otherwise possible seizure and sale

of the property for the contested tax while its validity was being honestly and diligently contested in the only way allowed by the law of the State, it will not do to say that the taxpayer has made an unconditional "payment" in apparent "satisfaction" of the contested part of an asserted matured tax liability, and thereby rendered it immediately accruable.

We therefore conclude that $10 of the contested $15 tax liability accrued not in the year of the remittance, but in 1951 when the New York court entered its final order determining that liability; and that the $5, for which respondent was held not liable by that judgment and which was returned to it by the city, was not income to respondent in 1951.

Affirmed.